

LITIGATION ABUSE REFORM ACT OF 1986

HEARINGS

BEFORE THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 2038

A BILL TO AMEND THE FEDERAL RULES OF CIVIL PROCEDURE
REGARDING DISPUTE RESOLUTION

S. 2046

A BILL TO PROVIDE LIMITS AND PROCEDURES IN CERTAIN CIVIL
CASES

FEBRUARY 21 AND MARCH 26, 1986

Serial No. J-99-86

Printed for the use of the Committee on the Judiciary



U.S. GOVERNMENT PRINTING OFFICE

62-412 O

WASHINGTON : 1987

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

3521-41

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LITIGATION ABUSE REFORM ACT OF 1986

FRIDAY, FEBRUARY 21, 1986

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Mitch McConnell presiding.

Also present: Senators Simon and Specter.

Staff present: Victor Maddox, counsel.

OPENING STATEMENT OF SENATOR MITCH McCONNELL

Senator McCONNELL. The committee will come to order.

Chairman Thurmond is unable to be here this morning and has asked me to preside in his stead. He did have an opening statement which I will insert in the record.

I also have a rather lengthy opening statement which I am going to also insert in the record.

I know a number of you have been hitting a lot of hearings this week. We are glad to have you here. This is an issue which is clearly a matter of grave concern all across the land and I am glad that it is getting the kind of attention it deserves at the Federal level.

We are here today because America's court system is in a crisis. We can no longer deny that some Americans are using the court system to solve any and every problem imaginable. Americans are obsessed with litigation and it is causing serious problems. The result is overcrowded courts with long delays in trials, exorbitant damage awards for liability cases, and consumers who are footing the bill for constantly rising insurance premiums.

Let me give you just a few examples of a judicial system which has, in my opinion, gone awry:

The Corning Glass Co. paid \$804,892 to a homeowner after the man was injured by a shard of glass when a Corning Ware dish broke. Why? Because the company failed to tell the owner that the dishes might fall and shatter if stacked five deep, with their lids inverted, in the kitchen cabinet.

A gymnast in California was awarded \$14.7 million after suffering a neck injury in a gymnastics accident. Who paid? The company who made the gym mat on the theory that the company failed to tell the man of the potential danger. Of the damages awarded, \$4 million was solely for pain and suffering. I repeat, solely for pain and suffering.

In the same case, the owner of the gym, who was considered to be 4 percent negligent was forced to pay \$590,000. Why? Because he bought the gym mat.

This issue was once an obscure and arcane legal problem, but it is now a matter of concern to all of us because we all pay more for insurance, if we can get it at all. We all pay more for goods and services or watch our neighbor—small businessmen and women—go out of business as a result of these outrageous awards.

For example, the high cost of insurance is forcing a private day care center out of business in Louisville, KY, and this means many young working mothers will lose a safe and affordable means of caring for their children. Many municipal corporations face increases of up to 900 percent even if no claim has ever been found against them. And certainly the enormous claims found against companies like Corning Glass are passed on to the consumer in the form of higher costs of dishes like these they manufacture.

Already, 42 State legislatures have realized the extent of this national problem and are meeting to deal with this crisis. These State legislatures are being forced to come face to face with real problems in their community: Firehouses closing because they cannot get insurance, city council members resigning because they are liable in suits against the city after liability insurance is made too expensive or canceled.

We here in the Federal Government can no longer deny that we have a liability crisis, nor can we ignore the need for a careful and critical examination of developments in our civil justice system and the substantive law of torts.

The fact of the matter is that billions of dollars are spent on the administration of the U.S. tort system. One study showed that easily 60 percent and perhaps as much as 75 percent of this money goes to support a generally well-off class of lawyers, of whom there are some 650,000 in this country.

The most disturbing results of the litigation craze are the reductions in services, the unavailability of insurance, and the increased costs to consumers generally. The result, perhaps unintended, is a tort system that seems to seek out an individual, business, or government that has the ability to pay, perhaps because of this insurance, and that is then forced to pay regardless of whether they have been found to be responsible.

The bills I have introduced, S. 2038 and S. 2046, are designed to help resolve these problems. The Alternative Dispute Resolution Promotion Act will require attorneys to certify that clients have been apprised of alternatives to court action.

The second bill, the Litigation Abuse Reform Act, places a \$100,000 cap on pain and suffering awards and introduces other changes designed to impart some much needed restraints to our civil justice system. It also creates a new sanction against lawyers who initiate civil action without a reasonable belief the case can be won.

The ramifications of this crisis, and of the trends in tort law, are something that this committee has an obligation to examine and, if necessary, to deal with appropriately.

One of the things I hope the committee will learn today is the extent to which reforms of the kind proposed in S. 2046 will effect

real change in the amount of litigation, the size or extent of awards that follow from them, and the increased cost of insurance and goods and services. It may be that we will need to make an approach like S. 2046 applicable to damages in all courts or it may be appropriate that we provide certain incentives to States to adopt these or similar changes.

[The prepared statements of Senator McConnell and Senator Thurmond follow:]

PREPARED STATEMENT OF SENATOR MITCH MCCONNELL

Mr. Chairman, I want to thank you for holding this hearing at my request on an issue that I think we all recognize is extremely important. The liability crisis can no longer be denied. Nor can the need for a careful and critical examination of developments in our civil justice system and the substantive law of torts be ignored.

America's passionate love affair with the courts is threatening to choke off the vibrance of our economic well-being. It has created a crisis of confidence among Americans in our court system, in our legal profession and for its indifference to the problem, or, for its inability to cope with it, in our government.

It seems everybody is suing everybody else. Americans are resorting to legal action to solve any and every problem that comes along. The result is overcrowded courts with long delays in trials, exorbitant awards for damages in liability cases and consumers who are footing the bill for sky high insurance premiums. Something must be done to stop this mad rush to the courtroom.

Like many of us, I have been following the problems in the civil justice system for a number of years. As the chief executive officer of a large urban government, I experienced first hand the problems caused by excessive litigation, and by the need to devote ever larger amounts of a government's resources to defending against lawsuits in a wide range of areas. Individual citizens, perhaps to an even greater extent than government organizations, are likewise faced with similarly difficult problems, when a single lawsuit can amount to a disaster. Often citizens, businesses and government alike are faced with a dilemma: whether to defend the lawsuit, and to devote thousands of dollars and countless hours to the defense of the case, or to accede to the demands made by the plaintiff, and pay large sums of money where no liability exists.

We are all familiar with this problem, and the statistics seem to bear out the belief that our society is becoming increasingly litigious. The number of lawsuits filed in state and federal courts has continued to increase at a rapid pace. In 1985, the Administrative Office of the United States Courts reports that the number of civil cases exceeded 260,000, an increase of more than 100 percent from ten years earlier. Similar increases are seen in the state courts.

And it is not simply the number of lawsuits that is disturbing. The complexity as well as the damages involved in lawsuits has increased dramatically in recent years. The number of million dollar or even multimillion dollar verdicts and settlements has climbed to the point that there are now hundreds of such verdicts and settlements each year in our court systems. Billions of dollars are collected in legal fees devoted to litigation. At the same time, the amount of lost productivity and just plain aggravation that results from litigation is incalculable.

Of course, litigation is not necessarily a bad thing, nor are the results of litigation to be uniformly condemned. A great deal of good has come from the creative use of the court system by lawyers and judges. The free and open access Americans have to the judicial process and to an independent trier of fact is one of the basic freedoms so fundamental to this great nation. Yet we have an obligation to recognize that there is a limit, and that "all things in moderation" is perhaps the most sensible watchword for the day.

We must all recognize that there are costs associated with litigation and with the automatic, unrestrained resort to the civil justice system to resolve disputes. In addition to the costs of lost productivity and aggravation, there are the cost of actually administering the system. The Institute for Civil Justice of the Rand Corporation has estimated that the cost for all civil cases in the state courts amounts to \$300 per case, while the cost for such cases in the United States district courts amounts to \$1,500 per case. As the Rand Corporation recently reported "the total annual price tag for processing all the various types of civil cases is estimated at \$2 billion, including \$1.7 billion in state courts and \$0.3 billion in the federal courts—all of which is on top of what the litigants themselves pay."

The fact of the matter is that billions of dollars are spent on administration of the United States tort system, whether it be for lawyers fees, for administration of the courts themselves or for payment of awards and settlements to plaintiffs. One study recently indicated that, however, that only 25% of the costs of the United States tort system goes to compensate for economic loss. Other, perhaps more sophisticated studies, suggest that as much as 37% of the cost of the tort system are paid for economic loss of plaintiffs. The remainder, whatever the actual number, goes to support a generally well-off class of lawyers, of whom there are some 650,000 in this country. These are not particularly encouraging facts.

Perhaps that most disturbing consequence of the litigation explosion, of the costs of administering the tort system, and of the ever expanding use of courts to resolve civil disputes, are the reductions in services, the unavailability of insurance, and the increased costs to consumers generally. The Institute for Civil Justice reports that since 1970 there has been phenomenal growth in both the frequency and in the size of medical malpractice claims. Interesting enough, it also notes that there is a striking variation from state to state in the number of claims filed against doctors and hospitals. In California, in 1976, the number of claims for 100 physicians was 8.81. In Maine, in the same year, the rate was just 0.47. Consequently, we see a 12 fold range in the frequency in claims, and a 30 fold range in the size of claims, according to the Rand Corporation.

Reacting to these figures, a number of states have moved to cap verdicts or eliminate other abuses in the tort system. The results have been to reduce the amount of verdicts, increase the number of cases dropped, and to reduce the average award of claims. Similar results can be seen in the product liability and negligence fields. State courts have consistently expanded the basis for which liability can be found, and have concomitantly cut back on the reach and effectiveness of doctrines designed to combat legal liability. The results is a tort system that seems to seek out an individual, business or governmental entity that has the ability to pay, perhaps because of its insurance, and that is then compelled to pay regardless of the presence or absence of responsibility.

This state of affairs has been acknowledged by the Justice Department, which recently formed a Tork Policy Working Group to, in the words of Assistant Attorney General Richard K. Willard, "Rein in the runaway tort system and bring its costs under control." The American Bar Association has set up a similar group, and a variety of privately funded studies are under way. Numerous state legislators have passed or are considering legislation that would make changes, some of them relatively modest and some much more comprehensive. These are changes that are long overdue and that I ardently encourage. Similarly, legislation has been introduced in Congress that would modify product liability laws, encourage changes in medical malpractice laws and encourage a retreat from excessive use of litigation and the excessive award of damages.

The bills I have introduced, S. 2038 and S. 2046, are designed to do the latter. The Alternative Dispute Resolution Promotion Act seeks to encourage the use of alternatives to traditional litigation, by requiring attorneys to advise their clients of the alternatives and permitting clients to make offers to engage in those alternative proceedings. This is especially important in light of the studies indicating that the costs of conducting litigation—societal costs or public costs—increase dramatically as the case proceeds through the judicial system, reaching the highest level when the case is actually presented to a jury. If we reduce the extent to which we rely on this system, and on jury proceedings, we can significantly reduce the costs of litigation.

The second bill, the Litigation Abuse Reform Act, proposes a number of modifications in the law of damages in cases in federal court. In essence, it seeks to introduce a degree of predictability to the legal system, and to put reasonable limits on the amount of judgements that may be awarded for product liability, negligence and other tort cases. It also imposes additional sanctions on lawyers who file lawsuits without actually believing there is legal and factual support for an award of damages. Finally, it limits the fees lawyers can receive in a case so that a greater percentage of an award goes to the injured party.

Obviously, S. 2046 will not solve the entire problem. Because it only applies to cases in federal courts, we can imagine that many, if not most cases that might be filed in federal court today will be diverted to the state court systems. Given that there were more than 13,000 product liability cases alone filed in 1984 in the federal courts, this alone will serve as an important incentive for state courts to modify their own proceedings.

The ramifications of this crisis, and of the trends in tort law, are something that this Committee has an obligation to examine, and, if necessary, to deal with appropriately.

One of the things I hope the Committee will learn today is the extent to which reforms of the kind proposed in S. 2046 will effect real change in the amount of litigation, the size or extent of awards that follow from them, and the cost of insurance, goods and services generally that result. It may be that we will need to make an approach like S. 2046 applicable to damages in all courts, or it may be appropriate that we provide certain incentives to states to adopt these or similar changes.

We have a distinguished panel of witnesses today, and I'm looking forward to the testimony of each of them. I commend you again Mr. Chairman for focusing the Judiciary Committee's attention to this important issue and look forward to the testimony of the witnesses.

PREPARED STATEMENT OF CHAIRMAN STROM THURMOND

Today the Senate Committee on the Judiciary begins its examination of the rapidly expanding theories of tort liability. In the last decade, we have witnessed an erosion of the traditional concepts of fault-based liability, which have been gradually replaced by no-fault and strict liability theories. These developments have significantly increased the number of lawsuits that are clogging our court system and have contributed to the dramatic increase in the number and size of monetary awards.

While the underlying causes of these developments may be debatable, no one disputes the dramatic impact that expanded tort liability has on our lives. Liability, or the fear of liability, affects the price and types of products we buy, the manner in which we conduct business, the price and availability of insurance, the permissible uses of our land, the health care we receive, and even the way we care for our children.

This Committee has examined liability questions in earlier Congresses including the personal liability dilemma facing certain government employees and the indemnification and the reduction of liability of government contractors. More recently, this Committee has examined the lack of availability of insurance for municipalities and the underlying liability schemes of the Superfund program advanced by the Administration. The issues are complex and broad and deserve special attention.

I am most pleased that the distinguished Senator from Kentucky has chosen to take a leadership role on this issue. Senator McConnell requested these hearings and has authored two bills which may provide answers to some of the difficult questions which have arisen. He is to be commended for his dedicated interest and initiative in this area. We have an impressive list of witnesses from the business and academic communities. Due to other important commitments, I am unfortunately unable to be present today. Therefore, I have asked Senator McConnell to chair this hearing. I look forward to reviewing your testimony.

Senator McCONNELL. We have a distinguished panel of witnesses today which we are very pleased to have here, and I just might make two further observations before we call on our first one. There will be two subsequent hearings on this subject in this committee on March 25 and 26, specifically on the two bills that I have introduced.

The subject matter today, of course, is on the general problem but we are happy to hear any reference to any bills that may have been introduced as well, but I wanted to alert you to the fact that this committee is going to continue its inquiry into this subject on March 25 and 26. Also next week I will be introducing in the Senate a resolution calling upon all 50 States to act forthwith to deal with this crisis. As I indicated in my opening remarks, many are dealing with it already, and this may be one of those rare occasions where States are moving before the Federal Government.

This is a real and immediate crisis that requires attention and I think the Congress ought to encourage all the States to act.

I am pleased to welcome today as our first witness, a former Member of Congress, a friend of mine that I have known over the years, but he is not here because of that, Jim Coyne, a former Congressman from Pennsylvania, a former Director of the White House Private Sector Initiative, chairman at the moment of a new organization called the American Tort Reform Association, and it is in that capacity that he appears before us today.

He was educated at Yale and has an MBA from Harvard. He is also executive vice president of the American Consulting Engineers Council in Washington and he will be our leadoff witness. Mr. Coyne.

STATEMENT OF JAMES K. COYNE, PRESIDENT, AMERICAN TORT REFORM ASSOCIATION

Mr. COYNE. Thank you very much, Mr. Chairman. I would like, if I may have your permission, to follow your example and submit for the record a somewhat lengthier set of remarks and then with your permission make some more brief remarks after that.

Senator McCONNELL. Without objection, we will include your entire statement in the record. Go right ahead.

Mr. COYNE. Thank you very much.

My name is James Coyne and I appear before you as the executive vice president of the American Consulting Engineers Council and as president of the American Tort Reform Association. This is a week when, of course, our Nation pauses to pay its respects to our former Presidents, and it may be especially appropriate to begin with a quote from Abraham Lincoln.

Abraham Lincoln, a lawyer himself, of course, once said that the highest duty of an attorney was to discourage litigation. All of you on this committee are, therefore, fulfilling your highest duty as professionals and as Members of the Senate as you undertake these hearings to see what steps we must take as a nation to end a catastrophic explosion of litigation that our Nation has experienced over the past 25 years.

The dean of the Stanford Law School recently referred to the current situation as litigation pollution. Others refer to it as a chronic disease, a societal failing, a reflection of a generation of greed, or the transformation of our competitive economy into a spoils society.

Whatever the descriptive terms we use, it is clear that the public has reached the conclusion that our system of justice is no longer in balance.

Just last month, the so-called King of Torts, an attorney in Houston asserted that he was entitled to a \$2.5 billion fee for about 8 weeks' worth of work. The scales are tilted grotesquely in favor of plaintiffs and attorneys whose principal motivation is not redress of grievances, compensation for fault, but simply the exploitation of a system out of balance.

Our justice system has been handed over to a pack of pickpockets constantly seeking deeper and deeper pockets to pick. They cloak themselves, of course, in high-minded rhetoric and emotional self-justification, claiming that their cause is defenended by our Constitution and the Bill of Rights. In fact, nothing could be further from

the truth. The justice system of our Founding Fathers has almost no resemblance to the civil justice system that has been produced by 25 years of judicial unfairness.

To put these past 25 years in the best possible light, however, we can say that most of these changes were motivated by "the best of intentions." We have gotten to the point, nonetheless, where exposure to liability is becoming almost limitless and incalculable, making everybody—governments, businesses, professionals like consulting engineers as well as lawyers themselves, doctors, consumers, nonprofit organizations—all victims today.

In making these observations, I want to make it clear that I am doing it as a citizen, not as a former Member of Congress or former businessman or as a trade association executive.

Of course, as president of the American Tort Reform Association, I have had an opportunity to examine these issues first hand, together with experts across the country. This is not a partisan issue of Republican versus Democrat, rich versus poor, businessman versus consumer, doctor versus patient, taxpayer versus government official. It is an issue that strikes at the very fundamental issues of our society's cost and fairness of litigation in this country.

The American Tort Reform Association includes among its members more than 100 of the Nation's principal trade associations and broad additional public membership of individuals, law firms, businesses of all sorts, and nonprofit groups from across the country.

We have the support and encouragement as well of the Attorney General of the United States and many members of the American Bar Association. Furthermore, our general counsel, distinguished former Attorney General Benjamin Civiletti, together with distinguished members of our legal policy committee, are helping us to develop legislative recommendations at the State and Federal level that will bring our civil justice system more into proper balance.

Allow me first, of course, to put our civil justice system, and more specifically the tort reparation system, into proper perspective by looking at a few recent suits and their outcomes.

Recently, a drunk driver crashed off a highway across a curb and into a phone booth. Unfortunately, a man inside the phone booth was seriously injured, but the California Supreme Court held that it was the designer of the phone booth who was liable for the man's injuries because he should have seen that an automobile driven by a drunk driver would have attacked that phone booth at high speed.

A thief fell through a skylight while burglarizing a school. It was the school district that was sued and its architect. The thief recovered more than a quarter of a million dollars in damages and a continuing income for damages against the designer of the school.

An engineer designed a condominium for Palm Springs, CA. Without his authorization or knowledge, plans for that condominium were taken by a third party and used to construct another facility in a ski area in Colorado. The first winter's snow fall caused the roof to collapse. The injured parties successfully sued, alleging that the designer should have known that the plans would have been used in a different location from that in Palms Springs, CA.

A man tried to commit suicide by jumping in front of a New York City subway train. His suicide attempt failed, but he was in-

jured. He sued nevertheless, claiming that the train should have stopped. The transit authority settled for \$650,000.

A drunk driver collided with a speeding car at an intersection. The truck driver had "run" a stop sign. The passenger in the car sued and a court found that the county and the county's engineer were 1 percent at fault for failing to erect a "caution truck crossing" sign in addition to the stop sign. The other parties had no funds, so that although he was only 1 percent at fault, the county and the engineer were forced to pay the full settlement of over \$1 million.

A little league player was injured when a fly ball hit him on the head. His parents sued the coaches on the theory that the coaches were negligent in putting their son in the outfield. The parents recovered a settlement and as a result the athletic league may have to be disbanded.

These are only a few of the cases. You have mentioned some others, and of course there are hundreds and hundreds if not thousands of additional ones. But beyond these cases and the settlements there is the extremely negative effect on our society that the threat of irrational litigation has produced. Something is wrong when parents can get paid damages because their child cannot catch, or a designer is liable when a telephone booth doesn't withstand a speeding auto attack. Something is wrong when a burglar can recover from the victim of his burglary, or a person can sue because he is injured while trying to kill himself.

Why is all of this happening? The fact is that the civil justice system as we know it has been turned on its head. The system no longer provides a clear definition of liability or who should recover because of another's fault. It encourages plaintiffs to sue and to sue and to sue. It hampers the defense and makes incredible awards. It has stretched the line that defines responsibility for a defendant who is "truly negligent" to one who is merely an "innocent bystander." As a result, our system is overloaded and it fails to provide prompt, just, and full compensation to injured victims at a reasonable cost.

For most of our country's history, we had a stable tort system. There was a balance struck between the English common law and the American court decisions of the first 150 years or so of our Nation's existence.

With limited exception, a person suing could only recover if he proved that the defendant was at fault, that the defendant's negligence caused the injury. Plaintiffs could usually get damages for intangible pain and suffering only if there was an accompanying physical injury. Punitive damages were available for only truly outrageous conduct.

The tort system of today has been radically changed in only 25 years. Our generation has overturned 200 years of legal tradition. Courts have injected the common law doctrine of sovereign immunity. The concept of fault has been tossed aside in case after case.

An injured person frequently does not have to prove any negligence, just that the injury might have been prevented by a different design or a different set of actions. That is how you get lawsuits against telephone booths or condominium designers who have not made their product crash-proof or snow-proof in Palm Springs.

Courts have changed the standard of care required by defendants, extending the duty of utmost care to even the victims of criminal trespass. The concept of joint and several liability has been outrageously expanded to where virtually faultless defendants, if they have got a deep pocket, can be found 100 percent at risk for damage awards.

Not only has legal doctrine been substantially altered, but the dollar value of awards has ballooned. The tort system today has more million-dollar winners than a State lottery. In 1984, the average product liability verdict was over \$1 million. The average medical malpractice award was \$950,000. Today's courts have made punitive damages the standard rather than the exception.

In recent cases between two litigants arguing over the difference between a \$4,500 and a \$17,000 settlement of a case, the court awarded more than \$7 million in punitive damages to the losing party. Regardless of who was right or wrong, the punitive damages awarded were totally out of proportion to the claim at hand.

Huge damage awards are a recent phenomenon. The first \$1 million tort verdict was awarded in 1961. This year we expect more than 500 cases to pass the \$1 million mark.

Finally, the transaction costs of our tort recovery system are outrageous. These are the legal accounting, investigating costs, as well as the administrative costs to the courts. In 1984, the tort system was estimated to cost 37 times as much as it did in 1950. Legal defense costs have risen to 25 cents on the premium dollar compared to only 5 cents on a dollar 25 years ago.

But as lawyers know, money is just money. If everything gets more expensive because we decide to maintain our current court system, somehow we will all muddle through. But our standard of living will go down. We will become less competitive in international markets. Small companies will go out of business. What is more frightening is that soon there may be some necessary products and services that are no longer available at any price. Moreover, the volunteer and pioneering spirit of our Nation will be irreparably damaged, as risk becomes not a challenge but a concern on the willingness to dare the innovative.

Our Nation's symbol of Uncle Sam will sadly have to be replaced and renamed Uncle Sue.

Day care centers across the country are closing their doors. Many parents now have the attitude that if little Susie hit Johnny with a building block it is grounds for a suit, claiming inadequate supervision and demanding punitive damages. The result has been, as you said, that many day care centers simply cannot afford or even find insurance at any price.

Nonprofit organizations and local government boards are having trouble finding people to serve. Community service, as we all know, is rewarding, but not so rewarding that we should risk our savings in a lawsuit for the privilege of volunteering our time.

Life-saving products are being withdrawn because the threat of product suits is so overwhelming. In the last 3 years, seven companies have withdrawn from the business of making anesthesia machines, and only two are left. Johnson & Johnson recently withdrew a drug designed to prevent sudden infant death syndrome, not because it did not work but because if it were given to high-risk

infants, some of whom might unfortunately succumb, the company would be exposed to the inevitable lawsuits.

Consulting engineers designing hazardous waste cleanups and asbestos removal are refusing to perform these services because they cannot find insurance to cover their work and they are unwilling to bet their firm and their careers under the prevailing strict liability rules.

What we are all facing is an issue that is very important and severely affects our society. The pendulum of the American tort system has swung too far. The desire to reward every claimant is creating too great a price.

In fact, many of us live in mortal fear of being sued, particularly if we have, or through insurance have, access to money. We can no longer count on being protected by the law, for even if we win we will lose in the enormous cost of defense.

Some people are quick to describe the current tort liability crisis as a "conspiracy of the insurance industry." Insurance industry representatives acknowledge that they have made some mistakes, but defend themselves by pointing out that insurance is, after all, nothing more than the prepayment of future litigation expenses.

The current uncertainty surrounding litigation costs leads most reasonable observers to conclude that trying to predict the course of future litigation expenses is like trying to predict the course of an epidemic spreading across America.

It is the view of the American Tort Reform Association that the problems manifest in the insurance industry are largely symptomatic of the underlying disease that you call hyperlexis. Only by dealing with this disease can we solve the public problem at all levels.

Furthermore, those who try to put all the blame on one party can be accused of trying to create a scapegoat and shifting the blame away from the more complicated subject of our tort system. There is no one party at fault. Lawyers, judges, juries, the public, the press—all have contributed to the spiraling liability expenditures. But in a nation of laws like ours, the fundamental solution requires that we look at the law, the rules that set the standards for civil procedures in our courtroom.

That is why I am so very pleased that you and this committee today are actively beginning to make a careful investigation of the steps that we must take as a nation. S. 2046 offers an excellent agenda for reforms of the Federal courts. S. 2038, dealing with alternative dispute resolutions, offers important further remedies and incentives to reduce needless litigation and we endorse them both.

These and other legislative proposals brought forward in other Senate committees deserve the support of the American people. We welcome this opportunity to present our views and we hope that you will move with speed before the situation gets further out of hand.

This year, 1 out of 12 adult Americans will bring suit against another. No nation in the world spends such a tremendous proportion of its national wealth in the courtroom, and sadly also our country has lost the most important element of its judicial system—common sense. I am proud that this committee will lead the effort necessary to reestablish common sense in our judicial system.

Thank you very much.

[The prepared statement of Mr. Coyne follows:]

TESTIMONY OF JAMES K. COYNE

EXECUTIVE VICE PRESIDENT

AMERICAN CONSULTING ENGINEERS COUNCIL

AND

PRESIDENT

AMERICAN TORT REFORM ASSOCIATION

Mr. Chairman, members of the Judiciary Committee, my name is James Coyne. I appear before you today as Executive Vice President of the American Consulting Engineers Council (ACEC) and President of the newly formed American Tort Reform Association.

If justice is blind we must do something to correct her vision. Because the vision of American justice has become so distorted, that the scales have been totally tipped to the plaintiffs, and particularly, plaintiffs that can afford high priced trial lawyers. The American civil justice system, which our Chief of Justice Burger has for many years decried, is in danger of seriously damaging our way of life.

Our system of civil justice is based on a fair hearing of the evidence and redressing of wrongs. Today its become an investigation of who has insurance and inventing a legal theory to show why the insured defendant should pay. We have moved from remedy based on negligence or fault to compensation based on injury, the more unlikely and outrageous the better.

Risk for local governments, independent businesses, professionals providing essential services was something computed far down in the budget and covered by insurance. Now risk is top of the agenda at city council meetings, board rooms, and universities. It no longer is a minor budget item for insurance, but is often not only expensive, but increasingly unavailable.

But more importantly, it has put many people in the "risk" business, people who must make the decision, "Do I dare continue to serve on this board of directors, this school board or town

council, this athletic or recreation league?" For many the answer is no. They have decided the risk isn't worth it. This is particularly true of small businesses, volunteer groups, local governments, and special purpose districts. That decision costs us all; not in dollars, but in the quality of our communities.

For the others who choose to take the risk, however, it changes the way they make the decisions that matter. Rather than innovation, new products, new services, new markets, public and private managers have to worry about, "What's the chance I'll get sued?" In this stifling climate of anxiety over unknown risk, our economic growth, perhaps even our spirit of adventure and pioneering, will be reduced.

How does this directly relate to consulting engineers? Our members have been consistently in the forefront of responding to the major challenges of this century. The great strides in transportation, communications, buildings, energy generation, pollution control and even historic preservation are all dependent on engineering, most of it done by independent professional firms. Yet what do we find today.

Liability insurance is today nowhere available for hazardous waste removal engineering nor for the design of the rehabilitation of federal buildings, when asbestos is present. Firms performing structural engineering necessary for construction of dams, wastewater treatment plants, bridges, as well as public buildings, experienced an average increase in premiums of 54% in 1985.

The pollution exclusion published by the insurance industry in mid 1985 may eliminate coverage for environmental firms designing pollution control systems for water and air.

But the root cause of the crisis we believe is not in the insurance industry, but the American civil justice system. Five years ago a small minority of our firms were sued by their clients to remedy design errors or by personal injury claimants. Today it is not uncommon for engineering firms to have multiple

suits at all times pending. Architectural/engineering (A/E) firms in 1985 averaged 109 new claims/100 firms and 210 claims pending/100 firms.

What we have in public, as well as private and commercial projects, is a crisis in tort liability. This crisis extends to every facet of business life.

What is the crisis of our tort system? For that matter, what is tort law? For those of you who are not legal scholars, tort law is the law of civil wrongs other than the breach of contract. It's the framework for most of the lawsuits in America today.

A little historical perspective is needed to understand how we got to where we are.

There are two broad areas of the law: criminal and civil. Tort law falls under the civil category and includes everything from slip and fall cases to automobile accidents to libel suits.

The rules in tort law center on what kinds of injuries can be compensated and what has to be proved to win the lawsuit. We inherited these rules from English common law. In the past, changes in these rules evolved slowly, largely from court decisions, not from statutes.

In America, we have 50 different state court systems and hundreds of federal courts that must interpret and apply these laws. There is often a difference between the rule in one place and the rule applied in another. Overall, however, most court decisions on tort law have followed the same general trend.

Surprisingly enough, even with all the minor adjustments and additions made through nearly 200 years of American court decisions, the balance struck by English common law remained essentially the same from the early 1800s until the 1960s.

With limited exception, a person suing could recover only if he proved that the defendant was at fault--that the defendant's negligence caused the injury. If the plaintiff--the person bringing the lawsuit--was the primary cause of his own injury through negligence or deliberate conduct, he could not recover.

Plaintiffs could usually get damages for intangible pain and suffering only if there was an accompanying physical injury. And punitive damages--punishment awards over and above compensation for injury--were available only for truly outrageous conduct. In other words, tort laws were defined in such a manner that one only obtained redress for cases of true negligence, not for the personal risks of everyday life.

The tort system we have today--only 25 years later--is vastly different. Our generation has overturned 200 years of legal tradition.

To illustrate recent changes, let's look at just a few of the important decisions of the last 25 years in California. I have chosen California because its lead has often been followed by other states.

In 1961, California rejected the common law doctrine of sovereign immunity, which for centuries had protected cities and states from lawsuits. In fiscal 1984, California cities--that's California taxpayers--paid out more than \$19 million in claims, up from \$5 million just three years ago.

In 1962, the concept of fault was tossed aside in the area of product liability. Now, an injured person doesn't have to prove any negligence--just that the injury might have been prevented by a different product design. That's how you get lawsuits against telephone booth manufacturers for not making their product crashproof.

In 1968, the California Supreme Court changed the standard of care owed by landowners, extending the duty of "utmost care" to even criminal trespassers. You can now see why a burglar robbing a school can successfully sue for injuries.

In 1975, California replaced the doctrine of "contributory negligence" with "comparative negligence." Comparative negligence allows an injured party to recover if he is partly--or even primarily--at fault for an accident.

Not only has legal doctrine been substantially altered, the dollar value of awards has ballooned. The tort system today has

more million dollar winners than a state lottery. You may think that the high awards you read about are aberrations, but in 1984 the average product liability verdict was over a million dollars. The average medical malpractice award was \$950,000.

Courts today also have become more liberal in awarding punitive damages. Recently, an insurance company disputed the proper settlement amount with a couple whose car was rear-ended. The insurance company offered \$4,500; the couple believed they were entitled to \$17,000. They sued, claiming the insurance company had failed to settle their claim in good faith, and recovered \$7.4 million in punitive damages. Regardless of who was right or wrong, the punitive damages awarded were totally out of proportion to the claim at hand.

And courts in many states are handing out extraordinary awards even where there is no physical injury, just the mental trauma caused by watching an injury happen to someone else, or the worry brought on by fear that an injury might occur in the future.

Huge damage awards are a recent phenomenon. The first million-dollar tort verdict was awarded in 1961. In 1983 alone, this country settled 360 cases for \$1 million or more. By comparison, in the entire judicial history of Canada, there have been only six \$1 million tort cases--and three of those cases, applying Canadian law, were decided by U.S. courts. No other country pays these huge amounts.

The financial cost of our tort reparations system is staggering: In 1984, the tort system was estimated to cost 37 times as much as it did in 1950. Commercial liability insurers alone spent \$2.9 billion defending suits in 1983; and legal defense costs had risen to 25 cents per premium dollar, compared with 5 cents per dollar in the 1950s.

Think of it instead as the dean of Stanford Law School did -- as litigation pollution, or more precisely, as a disease dramatically weakening our nation.

It's a disease with 16.6 million lawsuits in America last year (Japan had less than 1% as many). It is a disease which consumes as much as \$60 billion of our GNP, and wastes some of America's finest minds, best products, most successful research and production facilities and saps the creativity and energy of our public and private enterprises. And it's a uniquely American disease. Two thirds of the world's lawyers are in the U.S.

What are the symptoms? Such lawsuits occur everywhere -- sometimes for the most frivolous reasons. They are reported in any newspaper almost any day and liability awards from these suits show no relationship with fact, fault or fairness. The acute symptom of the disease is a plague of insurance policy cancellations and premium increases.

Most of the 1986 policy renewals among our members for liability insurance show increases from 50 to 900%. Furthermore, almost everyone's deductibles are being doubled and limits of liability are being reduced.

The consequences for hazardous waste cleanup engineers, as we described above, as well as nurse-midwives, day care centers, asbestos removal contractors, ski areas, small towns and community colleges, LP gas distributors, new drug companies, landfill operators and thousands more, are they have to go bare -- no one will write insurance at any price. They're facing bankruptcy, liquidation or the deadly game of litigation roulette. More than 13% of all ACEC firms went "bare" in 1985, but more sadly 1 in 3 of all of our smallest firms either cannot afford or cannot obtain liability insurance. As a result, the public is unprotected, as well as these independent businesses.

We're here today to introduce ATRA. We want to find a cure to this disease. We feel that basic tort reform is the only answer, together with a fundamental change in public attitude toward tort litigation. ATRA is the first and only national association to join together a broad army of public and private organizations to fight this litigation pollution. As you can

see, we include professionals and trade associations, some of the biggest and some of the smallest. Our charter member organizations represent more than 960,000 businesses, professionals, schools, communities, partnerships and public entities. Collectively, they employ more than 19 million tax paying Americans. And we expect more than 200 other associations to join within 30 days. We are all committed to curing this disease, lowering liability premiums, litigation expenses, and reducing the frequency of unjust and irrational lawsuits. We have a two-pronged agenda. First, build a broad-based bipartisan public organization with the resources and capabilities to demonstrate to our nation's policymakers what has to be done. Many lawmakers hear only the voice of the Association of Trial Lawyers of America (ATLA). In fact, the multi-million dollar war chest they've raised to oppose tort reform demonstrates how their own self-interest is leading them to ignore their duty to the public.

Second, we intend to carry this effort to 50 state capitals this year. Tort reform will not come only by the efforts inside Washington's beltway. It will be the #1 issue in at least 40 state legislatures this year. We stand ready to support these state efforts, especially with the help of the American Legislative Exchange Council, the leading organizations of state legislators concerned about tort reform.

Of course, national leadership is forthcoming. Attorney General Meese has created a special Working Group within the Domestic Council to propose tort reform proposals. Ass't. Attorney General Willard calls tort reform his #1 priority.

The membership of ATRA spent an afternoon at the White House just two days ago to air our concerns and explore ways we can help achieve our goals.

Chief Justice Berger tells the story of a small town with only one lawyer who is about to close up shop for lack of business. But then another lawyer moves in -- now both are thriving. The Chief Justice has called for tort reform and the Judicial Conference, which he chairs, is actively reviewing several proposals.

Of course, Congress, too, will hold hearings. We believe it fitting that the Judiciary Committee, which is responsible for the nation's court system and federal legal structure, is the first Senate Committee to hear the ATRA message. Tort reform will certainly be an important item on the Congress' agenda this year.

The battle has begun. Much has to be done. The public needs to get a better understanding of how the arcane subject of tort law so severely affects their lives and their livelihoods.

We are confident of the success of our effort because of the broad public and private support and interest we have already received. We are confident that our friends in Congress will be interested and committed to join us in this effort.

What is the solution? We can't look to the lawyers to solve the problem. Abraham Lincoln, a lawyer himself, once said that the highest duty of an attorney was to discourage litigation. While I certainly support his view, it is a tough standard. It's like asking doctors to discourage medicine or ad agencies to discourage advertising. In fact, just the opposite is happening as lawyers increasingly advertise for tort clients.

We can't look to insurance companies to solve the problem. As middlemen, insurers are in the business of spreading risks in a society, not picking up the tab for them. Insurance is unusual in that it must price its product to cover the cost of lawsuits today and many years into the future. As long as the courts define the rules, the policies will be competitively priced to reflect those rules. If the liabilities are undefined, the insurance cannot, or should not, be written.

Finally, we can't look to the courts alone to solve the problem. Courts are focused institutions which decide narrow cases involving the parties before them. Only occasionally do they see repercussions beyond the immediate case. If they did, they would probably not have set many of these recent precedents.

It took 25 years of case-made changes in doctrine to create our most litigious society in the world; but we do not have 25

years to correct it. The stakes are simply too high. So, if we can't look to the lawyers, and we can't look to the insurance companies, and we can't look to the courts to solve the problem, who can we look to?

The answer lies with us as citizens and with the legislature. But the legislature will not act until the voters make their voices known. Everyone must get involved because everyone is paying the price--municipalities, businesses, citizens and even the trial lawyers, who are themselves having trouble getting liability insurance.

It is time for all of us to step back and readdress some basic questions:

- o Is fault still important?
- o Where do we draw the line on defining and assigning liability?
- o Should there be limits on financial damages?
- o When does ease of suit cripple the productive elements of society?

These questions--and others--are big, important and complex. They must be thoroughly analyzed and debated at the local, state and national levels by everybody, not just the experts. We must understand the issues. We must talk to one another. We must involve our legislators. Only then will the system begin to change.

The following are some solutions we might consider:

1. Put limits on liability.
 - o Limit pain and suffering awards, particularly when there's no physical injury or when the injury occurred to someone else.
 - o Reduce size of awards where the impact of taxes, expenses and collateral sources are significant.
2. Punitive damages. The original justification for punitive damages was to deter outrageous behavior, willful and wanton misconduct. In recent years, this good standard has been diluted to the point of capriciousness.
3. Revive comparative negligence. This doctrine allows plaintiffs to recover large damages even if they are more responsible for the injury than the defendant.

That's what allows people who throw themselves in front of subway trains to recover hundreds of thousands of dollars from the taxpayers. It should be possible for judges to dismiss lawsuits at an early stage if the plaintiffs are clearly responsible.

4. Eliminate joint and several liability. The defendant should be financially responsible only for his own fault in the incident, and not for someone else's fault if that person can't pay.
5. Limit the contingency fee system. This encourages frivolous lawsuits and provides an irresistible incentive to extend the line on defining liability.
6. Create a mechanism for mandatory, non-binding arbitration of smaller claims , which make up the bulk of tort cases. If a plaintiff then carries his case on to the courts, he should pay defense costs if he does not prevail.

We think that the Alternative Dispute Resolution Act and the Litigation Abuse Act are two steps in the right direction. We urge the Judiciary Committee to become the Senate leaders for tort reform. Pieces related to specific professions or remedies have been introduced elsewhere but this is the Committee where the leadership focus should be.

Someone once said that people get the kind of government they deserve. In a democracy, it's also true that we get the kind of civil justice system we deserve.

I think we deserve a system that is predictable. A system that provides prompt, just and full compensation to injured victims at a reasonable cost. A system that does not make each of us a potential target for lawsuits arising from someone else's accidents. A system, in other words, that does not outrage our common sense notions of justice.

Thank you for the opportunity to present our views today. I will be happy to answer any questions.

Senator McCONNELL. Thank you, Mr. Coyne. I appreciate your references to the two bills that I have introduced and you are familiar with the capping of recovery on damage awards in the area of pain and suffering. I am wondering if there are any other reforms that might be appropriate other than those that I have addressed in my two bills?

Mr. COYNE. Well, we think in the broadest sense there are two important areas that have to be addressed right off the bat. One involves efforts to reduce the outrageous and unjust damage awards; the other is to reduce the mechanism that allows lawsuits to be effectively blackmail against innocent defendants.

Regarding the first of these, we think that your proposal of the \$150,000 cap on noneconomic damages for Federal court litigation is a very important step. Noneconomic damages in many cases have been tremendously abused and, of course, they are largely nonquantifiable. We think that the Federal legislature and in cases of State courts the State legislatures are eminently qualified to determine appropriate caps on noneconomic damages.

We want to stress, however, that our court system must always be allowed to provide full and fair medical and economic damage recovery. Allegations that reform means somehow reducing the ability of a just plaintiff to recover full medical and economic costs is certainly not your case or ours.

Also in the damage area, of course, is the issue of punitive damages. Of course, you have introduced the concept of assigning the punitive damage element of a court case to a public trust or to the judicial trust, rather than to the plaintiff lawyer. We think that is a very good idea to explore.

Punitive damages are intended to protect society by deterring outrageous conduct by defendants. There is no logic for those punitive damage awards to go to the trial lawyer or to the plaintiff. They should go to the public, and that is why we think that that restriction or reform of punitive damage awards is very important.

There are other reforms that can be achieved as well that will limit some of the outrageous awards by giving judges the authority to provide more direct oversight of the damage awards that are determined in a courtroom. Many times there is what we consider junk science brought into the courtroom and not effectively rebutted.

For example, last month in California a court awarded damages to a woman injured in an accident. She alleged that she contracted breast cancer because her body hit the steering wheel of her car in an accident. There is no body of scientific evidence that has ever been able to draw a relationship between that kind of concussion or bruise and breast cancer. The National Cancer Institute says that that allegation by her attorneys was entirely false. Yet those attorneys were able to bring so-called expert witnesses into the courtroom and with an argument that amounts to nothing more than junk science, persuade a jury that obviously is not skilled to deal with such complexity, to award a causation-based damage award.

Clearly, judges have got to be given the authority to bring and to overrule that kind of irrational damage award based on junk science.

The other problem area, of course is the concern that we have about blackmailing innocent defendants. We think the most important elements to deal with are the now-prevailing concept of joint and several liability and the now-prevailing concept that the ultimate winner in a frivolous suit still must pay their own expenses, however lacking in merit was the suit against him or her. This is called the American rule. The rest of the world, as you know, operates under the so-called English rule, where the loser pays the legal expenses of both sides. The English rule discourages frivolous suits.

The combination of contingency fees, the American rule and joint and several liability together has given many trial lawyers the capacity to bring entirely unjustified lawsuits against completely faultless defendants. The case of the New York City subway, I think, is an excellent example of that. The subway system was entirely faultless for that suicidal man's injury. But subway officials were forced to settle because they knew that in a courtroom, given the public's attitude toward the subway in general, maybe because of the overcrowding in the New York City subway or graffiti or whatever they might have lost or at least incurred far greater legal costs. They were unwilling to risk going before a jury and incurring all the costs of that litigation, even though they were obviously not at fault. They were forced to settle and they were effectively blackmailed.

We think that those types of reforms are important. The need to reform the joint and several liabilities, where you have a defendant who is 1 percent at fault and who can be held entirely liable for the award if the defendant who is 99 percent at fault cannot pay. Your legislative recommendations or considerations of this are very, very relevant.

Senator McCONNELL. You have covered most of the questions I was going to ask. I was a little bit disturbed, and I want to explore one other thing in closing. I was a little bit disturbed about a report in the Wall Street Journal yesterday that Attorney General Meese commented on Wednesday, and the headline said, "White House Now Appears Unwilling To Seek U.S. Curb on Liability Awards."

I gather that the Attorney General is saying in effect that, since most of the action in this area is in the States, that it quite possibly ought to be just left there. And my own judgment is obviously, or I would not have introduced the bills, that we need to move on two levels, both on the State level and the Federal level, and I am wondering what your reaction is to reports of his comments that we basically ought to hold back at the Federal level and let the States do their thing.

Mr. COYNE. Well, we think that it has to be addressed on both levels because we have, after all, court systems at both levels. We have State courts and we have Federal courts. In addition, we have areas of very appropriate Federal dominance involving products that are in interstate commerce. These stimulate lawsuits—in the aviation area, for example—where the inspection of all of the products and the regulation of the air traffic system are entirely administered by the Federal Government. Lawsuits involving Federal contractors or Federal payments, such as Medicaid and Medicare,

or situations where you have the Federal Government as the defendant—illustrate many, many areas of appropriate Federal legislation.

I spoke with the Attorney General's Office and I had the same question. This staff said they were very surprised at the article because the Attorney General's remarks at the meeting at the White House strongly supported Federal legislation where there was an appropriate Federal issue. These include the Federal courts, of Federal products and Superfund legislation, for example, where we are dealing with Federal contractors.

Senator McCONNELL. It could have been that he only objected to any kind of preemption approach.

Mr. COYNE. He fundamentally said that we are not trying to tell the State what to do with their own court system. That is very consistent with what you are proposing. I think that the Attorney General, were he here—and I certainly cannot speak for him—would say the same thing, that it is in fact an appropriate area of legislation at the Federal and State level.

All of us are conscious always of the appropriate balance between our Federal and State system. We think that the Federal Government will be a model for many of the States. Many of the States are looking for guidance, as historically our Federal court rulings have been in many cases precedents for State court rulings or State legislative action and so forth.

We very much support the strong leadership at the Federal level and we at the same time support very strong leadership at the State level.

Senator McCONNELL. Thank you very much, Mr. Coyne. We appreciate your coming.

I would like to call now Allan Thieme. Mr. Thieme is a small businessman from Albuquerque. He is representing the Chamber of Commerce of the United States, which of course as we all know is our largest federation of business companies.

Mr. Thieme's company, Amigo Sales, has offices in New Mexico and manufacturing facilities in Michigan, produces motorized wheelchairs and has experienced dramatic increases in its insurance costs in recent years.

Mr. Thieme, we are glad to have you.

STATEMENT OF ALLAN R. THIEME, MEMBER, COUNCIL OF SMALL BUSINESS, CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY ROGER MIDDLETON, ADMINISTRATIVE LAW ATTORNEY

Mr. THIEME. Mr. Chairman, I am here to present a summary on liability insurance. A full text was delivered to the committee yesterday.

Senator McCONNELL. We will insert your full text in the record and ask you to summarize.

Mr. THIEME. I do have Roger Middleton, from the chamber of commerce, who is an administrative law attorney for the chamber, who is accompanying me.

I am Allan Thieme, president of Amigo Sales, Inc. I am appearing on behalf of the U.S. Chamber of Commerce. I am a member—

Senator McCONNELL. Would you pull the mike a little closer to you?

Mr. THIEME. I am a member of the U.S. Chamber's Council of Small Business. The chamber appreciates this opportunity to present its views and it is a pleasure for me to be here.

There is an unprecedented liability crisis in this country which threatens the vitality of American business and the health of our national economy. The present insurance crunch causes severe hardship for businesses, professionals, and local governments, and it shows no signs of abatement.

One of the most vulnerable groups among us is small business people. They are the lifeblood of our economy. They create up to 80 percent of all new jobs, but the insurance crisis is forcing millions of us to the wall. We simply cannot afford insurance or are unable to obtain it at any price.

Expansion and innovation are stifled. No one is eager to undertake new ventures.

Mr. Chairman, I would like to share an experience with this committee of which I have intimate knowledge. My company, the Amigo Co., we make motorized wheelchairs, was recently sued for \$1.2 million. One day, while an Amigo wheelchair owner was operating her Amigo, she was struck by an automobile at an intersection. Not at any time was there an allegation that the Amigo malfunctioned, but rather the suit was based upon the fact that the device was not equipped with a reflector or lights. Such equipment is not standard in this trade for this equipment, nor were there ever any requests to customize the device in that manner.

We won the suite, but the cost of defending the suit to Amigo Co. was \$170,000. The concept of negligence, once the bedrock of liability law, seems to have disappeared. In liability law today, it is no longer a matter of who is at fault or whether anyone is at fault, but rather who can afford to pay.

My company has never had a successful claim against it, yet our insurance premiums were raised from \$30,000 to \$150,000.

As information has been pouring into the U.S. Chamber's national clearinghouse on the liability crisis, we can begin to understand the scope and depth of this crisis. We now know that these horror stories are not isolate, and entire industries have suffered. The chamber, through the clearinghouse, has undertaken an extensive survey of its members to determine the impact of higher premiums and in many cases lower coverage of their liability insurance policies.

Allow me to share with you some of the highlights of our survey. First, the survey of U.S. Chamber members indicates that businesses in every region of the country have experienced hardship in obtaining affordable insurance. We have found that almost 20 percent of the businesses surveyed have not been able to obtain or renew their liability coverage. Over 40 percent have had premium increases of between 100 and 500 percent, and nearly 10 percent have increases of over 500 percent.

General liability coverage presents the greatest problem, 60 percent, followed closely by product, 40 percent, officer and director insurance, 31 percent, transportation, 38 percent. Nearly 35 percent of the small businesses are considering going bare, operating their businesses without any liability coverage at all. Only 14 percent have contacted their State insurance commissioner about their problems.

Unfortunately, an incredible 95 percent believe the problem will become worse. Only when logic is incorporated into the civil justice system will some of these problems begin to correct themselves. Tort and civil justice reforms are critical to the solution of the crisis that America's businesses, professionals, and municipal and local governments face in obtaining affordable liability insurance.

The chamber enacted policy last week that recognizes the need for judicial reform as well as the cause and effect relationship between inadequacy in our court system and the availability of insurance.

Such a program of reform would first, develop uniform standards of liability that are consistent with the principle that those who are responsible for harm to the person or property of another should offset the harm that they have done; second, reform rules of damages, particularly as they relate to noneconomic loss and punitive damages; third, provide for alternatives to lay determinations of complex medical, scientific, and technological issues; fourth, develop fair and cost effective alternative mechanisms to replace private litigation for dispute resolution; and fifth, reduce transaction costs by regulating contingent legal fees.

Overall, we urge this committee to seek solutions to the underlying problems within the judicial system so that the problems for American business and consumers, which I have outlined, will not become worse.

Thank you for the consideration of our views and I will be happy to respond to any questions.

[The prepared statement of Mr. Thieme follows:]

STATEMENT
on
LIABILITY INSURANCE
before the
SENATE JUDICIARY COMMITTEE
for the
U. S. CHAMBER OF COMMERCE
by
Allan R. Thieme

I am Allan Thieme, President of Amigo Sales, Inc. in Albuquerque, New Mexico. I am appearing on behalf of the U. S. Chamber of Commerce, the world's largest federation of business companies, chambers of commerce, and trade and professional associations. I am a member of the U.S. Chamber's Council of Small Business which is composed of small business leaders who recommend small business policy to the Chamber's Board of Directors. The Chamber appreciates this opportunity to present its views. It is a pleasure for me to be here.

There is an unprecedented liability crisis in this country, which threatens the vitality of American business and the health of our national economy, as well as certain fundamental social objectives. While the present insurance crunch causes severe hardship for businesses, professionals, and local governments, it shows no signs of abatement. Small businesses are suffering especially. They are unable to self-insure, set up captives, or exercise other options that are available to larger companies. Neither do they have the bargaining power to negotiate a more favorable deal with insurance underwriters.

Recognizing this need, the Chamber's Council of Small Business called for the formation of an "Emergency Task Force on the Liability Crisis." Acting on the Task Force's recommendation, the Chamber's Board of Directors authorized the Chamber to initiate a broadly established public awareness campaign, to educate the public on the causes of the present crisis, and to seek solutions to the problem of obtaining affordable insurance. A listing of other Chamber activities on the "liability crisis" is attached to the end of my testimony.

Perhaps one of the most vulnerable groups among us is small business people. They are the lifeblood of our economy. They originate the ideas that become the mainstays of our economic future. They create up to 80 percent of all new jobs. But the insurance crisis is forcing millions of us to the wall.

These people are not reckless or unaware of the danger of their situation. They simply either cannot afford insurance or are unable to obtain it at any price. Most continue, hoping that they will not fall victim to a lawsuit or other action that will mean their ruin. Expansion and innovation

are stifled; growth comes to a standstill. No one is eager to undertake new ventures, since day-to-day survival is risky enough.

We all have heard by now more horror stories than we wish to recount on how this liability crisis has affected various segments of the American business community. However, Mr. Chairman if you would allow me, I would like to share an experience with this Committee of which I have intimate knowledge.

My company, the Amigo Company, a family-owned maker of motorized wheelchairs was recently sued for \$1.2 million by a husband and wife, both disabled, who owned and operated an Amigo. One day while the wife was operating the Amigo, she was struck by an automobile at an intersection.

Not at any time was there an allegation that the Amigo malfunctioned; but rather the suit was based upon the fact that the device was not equipped with a reflector and lights. Such equipment is not standard in the trade, nor were there ever any requests from the husband or wife to customize the device in that manner. The cost of defending the suit was \$170,000, and we won.

If you are wondering where the negligence was in this case, you are not alone. The concept of negligence, once the bedrock of liability law, seems to have disappeared. In liability law today, it is no longer a matter of who is at fault or whether anyone is at fault but rather who can afford to pay. My company has never had a successful claim against it, yet our insurance premiums were raised from \$30,000 to \$150,000.

As information has been pouring into "The U.S. Chamber's National Clearinghouse on the Liability Crisis," we can begin to understand the scope and depth of this crisis. We now know that these horror stories are not isolated and anecdotal, and entire industries have suffered.

Perhaps, the most important information gathered by the Clearinghouse to date has been the preliminary results of a "Business Liability Survey." The Chamber, through the Clearinghouse, has undertaken an extensive survey of its members to determine the impact of higher premiums and in some cases lower coverage of their liability insurance policies. The survey is an ongoing process, and additional responses are anticipated, but we do not anticipate that the findings will change significantly.

Allow me to share with you some of the highlights of our survey. First, the survey of U.S. Chamber members indicates that businesses in every region of the country have experienced hardship in obtaining affordable insurance. We have found that almost 20 percent of the businesses surveyed have not been able to obtain or renew their liability coverage. We believe that when almost one of every five businesses cannot obtain liability insurance, there is genuine cause for alarm.

Overall, over 40 percent have had premium increases of between 100 and 500 percent, and nearly 10 percent had increases of over 500 percent. Because of these increases, 20 percent have had lower profits, and 17 percent have raised the price of their goods or services. General liability coverage presents the greatest problem (60%) followed closely by product (40%), officer and director (31%), and transportation 38%. Nearly 35% are considering

"going-bare" -- operating their businesses without any liability coverage at all. Only 14% have contacted their state insurance commissioner about their problems. Unfortunately, an incredible 95% believe that the problem will become worse.

The survey continues by exploring opinions on the current state of the civil justice system. When asked why the number of liability suits and damage awards is increasing, 93 percent said that the civil justice system encourages frivolous claims, while 84 percent believe that liability is based on the ability to pay, not on wrongdoing. Ninety-six percent believe that the size of awards is excessive in relation to the economic costs arising from injury, and 91 percent believe that the number and outcome of claims against their business are unpredictable.

The final question that we asked is "which of the following approaches should the Chamber of Commerce pursue concerning this problem?" The answers were: 39 percent for civil justice reform; 63 percent for changes in insurance laws; and, nearly 48 percent for all of the above. Interestingly, the last choice was "no action," and only one person checked that response.

The survey findings confirm in greater detail the recommendations from the state meetings preceeding the White House Conference on Small Business. Two of the three leading recommendations concern this issue. The number one recommendation of the first 27 state meetings is tort reform, and product liability reform is the third leading recommendation.

But the figures are even more dramatic when we consider them on an industry-by-industry basis. The percentage of those unable to obtain insurance is much higher in the manufacturing industry, in which it is an astounding 30%. One-third of the manufacturers responding to the survey state that insurance premiums have increased between 100 and 500 percent. As a result, one-third of the manufacturers responding believe that higher premiums have led to decreased profits. In the transportation service industry, almost one-third of the respondents claim to have increased prices as a result of the insurance crunch. At a time of great distress for agricultural producers, over 40% will have experienced decreased profits as a result of this crisis. Likewise, over one-third of petroleum producers responded that premium price increases have led to decreased profits for their firms. One-fifth of all retailers responding say that they are dropping products or services as a result of their inability to obtain insurance.

It has become apparent that the lack of affordable liability insurance and the lack of insurance altogether are largely the result of a more general "liability crisis," which manifests itself in many different ways. Our survey results indicate that the public recognizes this cause-and-effect relationship. And, while the lack of affordable insurance is certainly a very visible symptom of this crisis, there are others that are equally important. Other symptoms of the liability crisis include the explosion of law suits, which characterizes our legal system, the abandoning of certain products by manufacturers, decisions to file for bankruptcy by large corporations due to

enormous liability exposure, and withdrawal by many from medical, accounting, and engineering professions.

I mention these other symptoms of the liability crisis not to diminish the magnitude of the insurance crunch, for surely this is alone potentially crippling. But even if liability insurance were somehow magically made available to all those who wanted it, the corporate bankruptcies would continue, product prices would increase, and professionals would flee from their professions under the threat of an American public that has a greater and greater propensity to sue. Only when logic is incorporated into the civil justice system will some of these problems begin to correct themselves.

Neither does awareness of the underlying inadequacies of our judicial system imply that short-term solutions to the insurance crunch should not be pursued. Although we recognize the enormous need for changes in our civil justice system, we should encourage insurance underwriters, as well as the state regulating bodies that traditionally have guided the industry, to develop programs that would ensure that all types of businesses have access to liability insurance coverage. We are encouraged that some states have successfully initiated "marketing assistance plans" and have created pooling arrangements under the guidance of state regulatory agencies. Similarly, we support the efforts of specialty trade associations to provide insurance coverage through programs that they have developed for their members, as well as the efforts of some businesses to self-insure or set up "captives."

Tort and civil justice reforms are critical to the solution of the crisis that American businesses, professionals, and municipal and local governments face in obtaining affordable liability insurance. And there can be no substitute for enacting needed judicial reforms, which would better enable insurance underwriters to predict the exposure to risk on which they base their rate-making. The often cited product liability horror stories of which we are so familiar, in which plaintiffs recover enormous sums based on jury sympathy or doctrines of deep pocket and strict liability, lead us to ask if it is any wonder that insurers are unwilling to offer coverage for activities for which they cannot predict the risk?

The Chamber is encouraged that there appears to be a genuine grass-roots movement across the country that supports reforming our judicial system. Over one thousand business representatives met simultaneously in town hall-type meetings sponsored by the Chamber in six cities last month. They learned from one another that their businesses were not alone in facing this liability crisis. Neither are they alone in seeking solutions. We know, through information submitted to the Chamber's Clearinghouse, that over half of the states have strong and growing coalitions seeking reform of our judicial system. We applaud the formation of such organizations and it is our hope that they can benefit by working closely with the Chamber's Clearinghouse. Within the next two weeks, we shall make available a listing of these coalitions to individuals and businesses that wish to join in this effort.

Creating a climate that would allow changes in the judicial system to occur is the goal of the Chamber's Clearinghouse and of coalitions working with it. Changes in our judicial system urgently are needed at both the federal and state levels of government. Although we are encouraged by such legislation as S. 2038, introduced by Senator Mitch McConnell (R-KY), and by Congressional hearings on insurance availability, as well as product liability, we previously have expressed our disappointment over the failure of Congress to pass the "Product Liability Act" last spring. A uniform federal product liability bill would substantially alleviate the present liability crisis, which underlies the problem of insurance availability. We reemphasize our desire to see Congress pass a product liability bill as quickly as possible.

The Chamber also is working to foster state tort reform with respect to medical professional liability. As it applies to health professionals and institutions, the present civil justice system is threatening the quality, availability, and affordability of health care in the United States. Our poll of Nation's Business readers and soon-to-be-released studies by the U.S. General Accounting Office reveal a broad consensus that everyone--health care providers, insurers, consumers, government, and business-- are ill-served by the medical liability system. In June of 1985, our Board approved a medical tort reform program, including state action to cap awards for noneconomic losses, require coordination of payments from multiple sources, pay large awards over time rather than in lump sum, and encourage filing of law suits within a manageable time after the discovery of alleged malpractices.

The Chamber enacted policy last week that recognizes the need for judicial reform, as well as the cause-and-effect relationship between inadequacy in our court system and the availability of insurance.

There is an urgent need to reexamine the premises of the litigation system. The business community, its chambers of commerce, and trade and professional associations have joined together to restore rationality to the system so that it can operate more efficiently and fairly. Such a program of reform would, among other things:

- o Develop uniform standards of liability that are consistent with the principle that those who are responsible for harm to the person or property of another should offset, to the extent of that responsibility, the harm that they have done.
- o Reform rules of damages, particularly as they relate to non economic loss and punitive damages.
- o Provide for alternatives to lay determinations of complex medical, scientific, and technological issues.
- o Develop fair and cost-effective alternative mechanisms to replace private litigation for dispute resolution.
- o Reduce transaction costs by regulating contingent legal fees.

Unless needed judicial reforms are enacted, this crisis will reserve ultimately its harshest consequences for American consumers. When

obstetricians withdraw from their profession, it is the quality of health care for all of us that suffers. When sporting goods manufacturers go overseas, it is the American worker who becomes unemployed. And, when, as one road construction firm reported to the U.S. Chamber, firms increase prices primarily to cover rising insurance costs, it is all of us who will pay more.

In fact, consumers as well as businesses already are beginning to feel the effects of the liability crisis. A growing number of corporations, in an attempt to limit liability, are abandoning certain products and, thus deprive consumers of the benefits of technological advances. Important vaccines, drugs, and medical equipment in the U.S. are becoming "endangered products." As a representative of Lederle Laboratories explained to a special Chamber liability crisis meeting in Chicago recently, they are the only maker of the oral polio vaccine. Two other companies have ceased production of the vaccine. Yet, this is but one example of a trend that the Chamber survey indicates could be much more far-reaching.

The present liability crisis also has the potential to be devastating to the American worker. Large manufacturers with high risks of liability are considering limiting their sales to overseas markets, where different legal systems permit consumers to assume more risks than in the U.S. The Rand Corporation reports that since 1971 six asbestos manufacturers, facing enormous payouts for victims compensation and litigation expenses, have declared bankruptcy.

At the very least, we can expect consumer prices to increase as a result of skyrocketing insurance premiums. In the construction and contracting industry, almost one-half of the businesses responding to the Chamber's survey indicated "increased prices" as one effect that the liability crisis has had on their firm. Almost one-third of the professionals responding indicated the same answer.

Mr. Chairman, we are very concerned about the detrimental effect this crisis portends not only for business but also for consumers. Based on information compiled in our Clearinghouse, it is difficult to imagine that either group could withstand extended periods of the hardship that they are now undergoing. It is our hope that the present ground swell of support for tort reform can be translated into laws enacted by Congress, as well as by state legislatures.

Overall, we urge this committee to seek solutions to the underlying problems within the judicial system so that the problems for American business and consumers, which I have outlined, will not become worse. Thank you for the consideration of our views -- I will be happy to respond to any questions.

ATTACHMENT 1

U.S. CHAMBER ACTIVITIES TO DATE

- o August 24th - "It's Your Business" program on the "crowded courts."
- o September, 1985 - Nation's Business poll on "medical malpractice reform."

- o October 3rd - Council of Small Business meets and recommends the formation of an "Emergency Task Force on the Liability Crisis."
- o October 24th - "Emergency Task Force on the Liability Crisis" meets and makes recommendations to the Board of Directors.
- o November, 1985 - "The U.S. Chamber's National Clearinghouse on the Liability Crisis" is created.
- o November, 1985 - Business Advocate cover story on the "liability crisis."
- o November 13th - Board of Directors recommends the establishment of a "Civil Justice Action Group" and "public awareness" campaign.
- o November 15th - Association executives meet with Chamber staff to promote association participation in future activities.
- o November 18th - "Nation's Business Today" features interviews with business executives.
- o November 24th - "It's Your Business" program on "medical malpractice liability."
- o November 26th - Chamber hosts an association briefing on the "liability crisis."
- o December, 1985 - "Small Business Journal" television program features a commentary on the "liability crisis."
- o December 1st - "It's Your Business" program on "product liability."
- o December 3rd - Government and Regulatory Affairs Committee addresses the product liability issue.
- o December 3rd - Chamber testifies before the Senate Commerce Subcommittee on Business, Trade and Tourism.
- o December 16th - "Steering Committee on the Liability Crisis" holds its first meeting.
- o December 17th - "Ask Washington" program on the "liability crisis."
- o December 17th - Chamber hosts a Washington corporate representatives briefing on the "liability crisis."
- o January, 1986 - Clearinghouse publishes its first monthly newsletter on the "liability crisis."
- o January, 1986 - Combined meeting of Washington corporate and trade association representatives.
- o January 23rd - Chamber regional conferences on the "liability crisis."
- o January 28th - "Steering Committee on the Liability Crisis" holds its second meeting.
- o February, 1986 - Nation's Business cover story on the "liability crisis."
- o February 4th - Chamber testifies before the House Committee on Energy and Commerce on the "liability crisis."
- o February 19th - Chamber testifies before the Senate Committee on Commerce, Science and Transportation on the "liability crisis."
- o February 20th - Chamber testifies before the Senate Small Business Committee on the "liability crisis."

PENDING U.S. CHAMBER ACTIVITIES

- o February, 1986 - "Civil Justice Action Group" to be selected.
- o February 21, 1986 - Chamber testifies before Senate Judiciary Committee
- o April 30-May 1, 1986 - Chamber co-sponsorship of a "National Symposium on Civil Justice Issues," in cooperation with Fordham University Law School and the Insurance Information Institute.

STATEMENT ON MEDICAL PROFESSIONAL LIABILITY REFORM

Why Should Business Have a Particular Interest In The Medical Professional Liability Problem?

Professional liability is no longer a problem facing just physicians and hospitals. Escalating numbers of claims and increases in the size of settlements and awards are pushing up health care costs and causing changes in the practice patterns of physicians. The changes ultimately affect society-at-large as higher costs are passed on in the form of higher fees and health insurance premiums. Equally important, access to some types of care, particularly complicated and high risk care, is restricted. The fact that medical professional liability problems are causing health care costs to rise is even more significant given the intensive efforts in the public and private sectors to contain health care costs.

Employers are, of course, well aware of the impact of rising expenses of employee group health care plans on their costs of doing business, and, thus, ultimately on their ability to compete. On the other hand, most employers may not be aware of the impact of medical professional liability on those health plan costs. In 1983, employers paid \$65.3 billion in health insurance premiums for their employees. The impact of medical professional liability on these premiums, while difficult to measure precisely, is significant. Estimates of the impact range from \$2 billion to as high as \$14 billion or higher. Thus, a significant percentage of the employers health insurance premium may be attributable to "defensive medicine" (i.e. the ordering of additional tests and treatment procedures as a response to the increased risk of a professional liability claim) and increased professional liability insurance costs.

What Indications Are There Of An Increasing Professional Liability Problem?

Beginning in the early 1970s, there were sharp increases in the number and severity of professional liability actions filed against physicians, hospitals, and other providers of health care services. What followed in the mid-70s was a period of instability in the market for professional liability insurance. First, there were rapid premium increases and, next, a dramatic decrease in the number of commercial carriers offering professional liability coverage for physicians and hospitals. In an attempt to alleviate the "malpractice insurance crisis," a number of states enacted tort reform legislation and/or statutes designed to assure the availability of professional liability insurance (such as through creation of joint underwriting associations). In the meantime, many state medical societies created physicians-owned professional liability insurance companies, and became actively involved in risk management, medical disciplinary and educational efforts to minimize preventable incidents of negligence or "malpractice".

By the late 1970s, it appeared that these measures and others had been effective in resolving the problem of availability of professional liability insurance, as well as having some positive impact on the number and severity of claims filed. However, what was hoped to be a resolution to the problem now seems clearly to have been merely a temporary respite.

In the last several years there have been sizeable increases in the number and magnitude of claims filed, which have resulted in medical liability insurance premiums going as high as \$100,000 in certain metropolitan areas. There is also growing concern that increased medical liability exposure for high risk medical specialties is causing some specialists to limit or even withdraw from their practices, thus reducing access to care.

In the last five years, physicians have experienced increased risk of incurring a claim as well as greater losses per claim. In 1979, according to St. Paul Insurance Company, physicians incurred malpractice claims at an average annual rate of 3.3 claims per 100 physicians compared with 16.2 claims per 100 physicians in 1983. The severity of losses has also increased substantially.

There is no evidence that physicians or hospitals are more negligent in their delivery of health care today than in the past. In fact, one of the effects of increased "defensive medicine" may have been to decrease the numbers and/or magnitude of medical errors. On the other hand the tort system has allowed adjudication of cases increasingly on the basis of adverse results whether or not negligence was clearly demonstrable.

Guides For Business In Helping To Resolve The Professional Liability Problem

Because increasing professional liability insurance premiums and defensive medicine add significantly to the overall cost of medical care, much of which is absorbed by businesses through increasing health care insurance premiums, business clearly has a vital stake in working toward a resolution of the problem. Since other sectors of the community, such as consumers, hospitals, physicians, unions, and the legal profession also have an interest in and a role to play in arriving at a fair and effective resolution of this problem, it may be that efforts to address the issue through health care coalitions will provide one very effective activity.

As a guide to dealing with the professional liability problem, the Chamber offers the following principles:

1. Medical professional liability problems are a concern to business, since they add unnecessary costs to the health care premiums paid by both employers and employees and may reduce access to care.
2. Local health care coalitions and other community organizations should be encouraged to work toward resolving the professional liability problem in their areas as one important method of reducing health care costs.
3. Efforts to resolve the professional liability problem must ensure:
 - speedy and efficient resolution of claims
 - fair and adequate compensation for injuries arising from medical negligence
 - a reasonable degree of protection from suits without merit so that access to care and costs of care are not negatively affected
4. Efforts to resolve the medical professional liability problem should include strengthened professional self-policing, risk management and peer review. Such efforts could be accomplished through public or private sector mandate and could include:
 - reporting of settlements and awards to the state medical board and to hospitals

- establishing risk management programs in hospitals
 - medical staffs reviewing and recommending action relating to medical liability awards or settlements involving a staff physician (with the hospital then reporting to the state medical board)
 - encouraging hospitals to require and confirm information regarding the professional credentials and work history of physicians seeking staff privileges. Hospitals should keep records on current and former physician staff for purposes of reference checks and disciplinary proceedings.
5. The tort system, as a deterrent to negligence and as a method of recourse after negligence, is beneficial to society and should be retained. However, reforms to the system are necessary to assure that it provides expeditious, fair and reasonable compensation for injuries resulting from negligence.
 6. Tort reform legislation should be enacted in the various states. One option which should be considered in order to encourage enactment of such state legislation is federal incentive legislation.

Examples of basic tort reform measures include:

- **Limitation on Non-Economic Damages**
Damages for pain and suffering and mental anguish are a primary cause of exaggerated professional liability awards because such damages are difficult to ascertain and are often influenced by emotion. The Rand Corporation estimates potential savings of 5-19% of medical liability litigation costs if non-economic damages are capped.
- **Structured Settlements and Awards**
Providing structured settlements with periodic payments over an injured claimant's lifetime will ensure that the money will be there when needed and reduce the cost of the award.
- **Elimination of the Collateral Source Rule**
There should be modification of the collateral source rule to prevent double payments.
- **Modification of Statutes of Limitation**
The time period in which a patient has the right to file suit against a physician for an alleged injury should provide a reasonable balance between fairness to the plaintiff and fairness to the defendant. Many states still have statutes that permit suits to be filed so many years after evidence relating to the alleged negligence is known that appropriate defenses to claims are impossible.

For minors, the statute of limitations in many jurisdictions begins to run when a minor reaches the age of majority. Physicians who treat infants and children thus face potential liability for more than 18 years. The statute should provide a reasonable period to discover any injury and file a claim — perhaps to age six or eight — but not extend liability decades into the future.

Senator McCONNELL. Thank you, Mr. Thieme. I appreciate it. I had a couple of questions with regard to your own experience with your company. How long did it take you to win the case?

Mr. THIEME. Two and one-half years.

Senator McCONNELL. Obviously, from your remarks you consider it a case against you that is frivolous and without merit?

Mr. THIEME. That is correct.

Senator McCONNELL. I assume you had to pay attorneys fees?

Mr. THIEME. That is correct.

Senator McCONNELL. Which were not covered by insurance. You had to pay the fees out of your own company—

Mr. THIEME. At the time that Amigo was built, we were unable to get any insurance at all so we were bare during the time of manufacturing of the product so we had to pay all the costs.

Senator McCONNELL. Would you have considered settling the case at some level, or was it a matter of principle to you to force it—

Mr. THIEME. No; we tried to settle it out of court.

Senator McCONNELL. So, at some level you would have been willing to settle?

Mr. THIEME. Yes.

Senator McCONNELL. It is a dilemma, though, is it not, when you feel like you are subjected to a frivolous claim and you would like to not let somebody be rewarded for that and still you are confronted with the cost of defense. Did that occur to you during this process?

Mr. THIEME. It is a very hard dilemma because of the costs for depositions and having special people come in. We were sure we could win, but you never know, so that is why we tried to settle outside of court and it was for \$250,000 that we tried to settle and they would not accept it.

Senator McCONNELL. The reason I raise that, I used to be the elected chief executive officer of a local government, a fairly large one. We were sued constantly, everybody for everything, and a goodly percentage of the cases that we were considering were completely without merit and yet we settled many of them simply to avoid the cost of defending them, and many times I was confronted with the dilemma that I really hate to let this plaintiff get away with this but at what price to the people which I was representing, how much of the public's tax dollars do I conscientiously spend in order to make the principle, and I found it to be quite a dilemma, and unfortunately our conclusion was that in many instances we simply allowed ourselves to be held up, if you will, and we ended up settling the cases even though as a matter of principle—

Mr. THIEME. Yes.

Senator McCONNELL [continuing]. I would like to have fought them through to conclusion because I was fairly confident that in many of these the plaintiff would get nothing.

Mr. THIEME. Being the head of a company, you cannot just look at the principle of it, which we would like to, we have to look at—

Senator McCONNELL. You have got your shareholders.

Mr. THIEME [continuing]. The dollars involved.

Senator McCONNELL. Now I have got my taxpayers.

Mr. THIEME. Yes; a major concern that I see, especially in the health care industry, many manufacturers are talking about and looking at the possibility of manufacturing outside of the United States because of a lesser problem in the product liability system.

Senator McCONNELL. I am sure this is going to be addressed by other witnesses, but we have the most litigious society in the world, and almost anywhere else you go you are going to confront this problem much less so than you are here.

Let me ask you, at any point in your own litigation was the subject of alternative dispute resolution raised to any consideration of getting outside the court system to settle the case?

Mr. THIEME. I tried to meet personally with the people that were involved. We also have a man on the staff that will whenever there is a problem, he will try to contact the person and work it out before—

Senator McCONNELL. What I am talking about is alternate dispute resolution, which is the subject of one of the bills that I introduced. It is a device by which you settle the problem outside the court system. It requires, of course, both parties to agree to that, to get it outside the court system and then you end up arbitrating the case or you have a minitrial or some of the other standard devices for alternate dispute resolution. I just wonder if that ever came up as an alternative way to settle your particular case. It frequently does not, but I just wondered if you all considered it.

Mr. THIEME. No; it has not and it would be a tremendous help to the small business people if there was some type of outside arbitration system in these cases. We would welcome that type of a program.

Senator McCONNELL. How much time was devoted to the defense of your lawsuit by yourself or other employees of the company, and do you have any idea how much the lawsuit cost you outside of your attorney's fees which presumably you could quantify? What about the nonquantifiable costs of defending the suit?

Mr. THIEME. That is a very big cost to a company that is almost impossible to put a factor on. The legal cost, the attorney cost was \$170,000. I would estimate the in-house cost of myself testifying, preparing for, preparing our attorneys, having—I had one man in our company that worked full time over this 2½ years—I am sorry, not full time, but he worked on this case for 2½ years, I would estimate he probably put in 8 to 10 hours per week on that subject. Then we also had to bring in engineers and our own engineers to get facts, the paperwork that we have to go through and read and things we have to pull up from our files back 5 to 8 years ago—

Senator McCONNELL. Just give me a ballpark estimate. Do you think that it might have been another—\$170,000 for your—

Mr. THIEME. I would estimate around \$45,000 to \$50,000.

Senator McCONNELL. Over and above the \$170,000.

Mr. THIEME. Yes; that is not saying what it does to the mental anguish of us and all people involved in our company.

Senator McCONNELL. What do you see as the future of small business in the country if we don't do something and do something very soon about the whole liability crisis?

Mr. THIEME. Generally, the small businessman is an entrepreneur and they love business and they love to grow. I feel that they

will find some way around it, they will adjust to it. They will have to raise the prices quite a bit to the end consumer and I am also very concerned that many of the small business manufacturers will look to products that are built outside of this country, and that is the sort of thing we have to stop. We need to do more manufacturing here and more exporting, instead of importing.

On the legal system, some things that I ran into—it is away from the question and I just want to bring it up—having just each State set up separate laws, where in our company, when we manufacture a product that goes throughout the United States, it makes it tough to have independent State laws where we could have something more uniform would help small businesses tremendously.

Senator McCONNELL. On that general subject, does the chamber of commerce favor a uniform Federal approach to tort reform?

Mr. MIDDLETON. Yes; we do, Mr. Chairman.

Senator McCONNELL. Thank you very much, Mr. Thieme and Mr. Middleton.

Mr. THIEME. Thank you.

Senator McCONNELL. Our next witness is Linda Locke, who is advocacy director of the Community Coordinated Child Care an organization in Louisville, referred to as the Four C's. The Four C's is a United Way agency in Louisville engaged in providing support services for the child care industry.

Ms. Locke has conducted through the agency a statewide survey of the effects of the liability crisis on providers of child care in the State of Kentucky. This is a very interesting survey and we look forward to your testimony, Ms. Locke.

**STATEMENT OF LINDA LOCKE, ADVOCACY DIRECTOR,
COMMUNITY COORDINATED CHILD CARE, LOUISVILLE, KY**

Ms. LOCKE. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, we thank you for your recognition of the importance of the day care industry to our national economy as evidenced by your invitation. We deeply appreciate the opportunity to testify on the insurance crisis in child care.

My name is Linda Locke and I am the advocacy director of Community Child Care [Four C] of Louisville-Jefferson County, KY.

Senator McCONNELL. Ms. Locke, let me interrupt for just a minute. You know that we will put your entire statement in the record.

Ms. LOCKE. That is correct.

Senator McCONNELL. And you are summarizing it, are you?

Ms. LOCKE. I will be summarizing it, yes.

Senator McCONNELL. Go ahead.

Ms. LOCKE. As I understand it, you wanted some of the data that—

Senator McCONNELL. Right. We are particularly interested in the survey which I think is quite good.

Ms. LOCKE. OK. This particular crisis not only is affecting Kentucky, but is affecting all child care facilities throughout the country, whether they be private, whether they be for profit, nonprofit, church, community sponsored, or Head Start. When I speak of the

crisis in child care, I want to emphasize that I am not speaking just for Kentucky. However, the survey data which I will summarize is from Kentucky.

One of the concerns that we have about the insurance crisis is that it is starting to close child care facilities. We did find some child care facilities within the State of Kentucky that had closed because of the insurance cost. We have heard from three other child care facilities that said if they get the anticipated insurance increases again this year, they will have to consider closing this fall.

This particular survey was conducted for the Kentucky Interim Joint Committee on Banking and Insurance. This committee wanted to collect claims history data from the child care industry in Kentucky beyond the data that was being provided from the Kentucky Insurance Commissioner's office. So this is the reason that the survey was conducted.

A summary of some of the data: 43 percent of the licensed child care programs in Kentucky responded. Of those responding, 52 percent cited significantly increased rates, ranging from 53 to 900 percent in a 1-year period of time.

Forty-one percent of those responding reported cancellation or non-renewal of the insurance coverage. On the claims history, however, 25.8 percent reported at least one insurance claim in 5 years. Of these claims, 85.4 percent were under \$300. No claims for child abuse were reported. While the survey was anonymous, it specifically asked if child care directors had knowledge within their areas of other claims that had been filed. It was hoped that if there were other claims throughout the State, that they would be listed. However, no claims for child abuse were listed or reported.

Of the different programs, family day care reported the fewest claims, but they reported the highest premiums. Nonprofit and church sponsored centers reported the highest number of claims, yet they had the least problems in finding insurance at the lowest cost.

In summary, there seem to be no correlation between the number and amounts of claims filed and the decreased coverage and the higher rates being charged.

The survey pointed out some specific problems and I would like to summarize those at this point. The first problem was the tremendous cost in liability coverage. I would like to point out that child care programs, as you are well aware, many times have subsidized families. There are no parent fees to increase because they receive a set amount per child.

Marginal income families, centers were reporting to us, are withdrawing their children from centers and seeking care that is unregulated.

Child care programs operate on a shoestring budget. I am attaching a letter from a nonprofit center in Berea, KY, to report she has eliminated a staff position to pay for the cost of her insurance. This is precisely what should not be happening with the children. In my written testimony I am including some additional comments from other respondents.

The second problem cited was that current policies contain exclusions which do not cover the program against claims of physical or

sexual abuse to children. We understand that is always potential in child care for things to happen when dealing with children. However, national data on child abuse cases documents that only one-half of 1 percent of child abuse happens in child care; yet insurance companies are excluding this claim from the policies.

What this does is put child care professionals in a precarious position because they are mandated by law to report any incidents of abuse. We are putting them in this position when they report an incident that they know is not covered if any litigation may result, whether the accusation bears out or not.

The third problem is companies are refusing to write insurance if the program serves special needs children. This is a very severe problem in Louisville. We do have a mainstreaming program, and we have worked very hard to get special needs children into child care and to train people in child care to care for these children.

An example: Old Louisville Children's Center in Louisville, a Metro United Way agency, has five special needs children. They were notified in December by their insurer that the company would no longer cover the children. They finally found a company willing to do so at \$5,000, \$1,000 per child, already on top of their increased insurance. I include an article from the Louisville Courier-Journal that documents this particular problem.

The fourth problem is homeowners and building insurance policies are being canceled because of onsite child care facilities, even though separate liability on the child care is being carried. I would like to read excerpts of an attached letter from a child care owner-operator who lives in Grayson, KY. This is a very rural part of Kentucky and there is not a lot of licensed child care in this part of the State. It is very important to keep her in operation:

I mortgaged our home for enough money to add a day care center onto our home. I had a homeowner's policy, but was immediately told they would not renew my policy because of the children. We had carried this policy for more than 20 years and never turned in a claim. I have liability insurance on the center and am trying to get homeowner's coverage, with so far no success.

My husband is disabled and this is my means of earning a living for my family. I stated earlier that my home is mortgaged and they will call in my mortgage if insurance coverage is not properly met by January 15. The center is State licensed. Please let me hear from you.

I would like to tell you that we did call her and she got in touch with the State insurance commissioner's office. He had a very hard time locating insurance for this person, but was finally able to get coverage for her only for fire. She could not get a homeowner's policy because of the child care.

A fifth problem is insurance companies are establishing underwriting standards for insurability that are in excess of State licensing standards. Insurance companies are overriding the State's authority to regulate and set child care standards.

The State of Kentucky requires a staffing ratio of one adult for each six children under the age of 2. However, one of the few companies still writing liability insurance requires a one to three staffing ratio for children under 2. This significantly increases costs not just of insurance, but of the total operating cost of the center.

One program in Louisville wrote:

We got a call this week and, although our insurance is paid through August, unless we reduce our staffing ratio to one to one in some ages and one to four in others, they may cancel us in 45 days. We cannot meet these requirements.

In conclusion, the data from the Kentucky survey documents that there seems to be little correlation between the increases, decreased coverage limits, and claims history in child care. We are seeing child care programs that have given up and closed. This is important in a State with only 41,000 licensed day care slots, and that includes centers in homes, and as of 1980, 187,000 parents in the work force with children under 6.

According to the Kentucky Insurance Commissioner's office, Kentucky is not a State attractive to large insurance companies. The subcommittee in Kentucky studying this problem is concerned that any legislation that they introduce which would require insurance rates based on claims history or require them to include physical/sexual abuse in their coverage will only result in no companies writing this coverage.

Keeping this in mind, they are developing a bill that they hope will make Kentucky more attractive to companies insuring child care programs. However, the subcommittee feels that if they introduce legislation favorable to insurance companies such as capping damages, then the insurance companies should on the other hand agree to certain provisions such as reasonable rates based on claims experience and inclusion of coverage of physical/sexual abuse.

We do not presume to judge whether the crisis is fueled by speculation or solid evidence. We are not insurance people and we do not presume to judge whether judicial reform will result in a more reasonable market because we are not in that field, either.

However, we are certain that the real victims of the crisis are our children and families. They are the ones that will have to pay increased costs, they are the ones that will suffer when staff is let go to pay for insurance.

Yet this is the resource that helps assure safe and healthy development of children in child care—the staff. That's where we should spend increase parent fees—not on the cost of insurance.

We would like to say that 4-C as well as other child care organizations throughout the country offer our assistance as you work to alleviate this crisis.

Thank you.

[The prepared statement of Ms. Locke follows:]

PREPARED STATEMENT OF LINDA LOCKE

Mr. Chairman, Members of the Committee, we thank you for your recognition of the importance of the day care industry to our national economy as evidenced by your invitation today. We deeply appreciate the opportunity to testify on the insurance crisis in child care.

My name is Linda Locke and I am the Advocacy Director of Community Coordinated Child Care (4-C) of Louisville-Jefferson County, Kentucky. Community Coordinated Child Care (4-C) is a private, non-profit United Way agency dedicated to quality care for children, in the belief that every child in our community should have the opportunity to achieve his or her maximum potential. In pursuing this purpose, 4-C (a) coordinates and develops resources for young children, (b) gathers and disseminates information on Early Childhood, and (c) serves as an advocate for children and families. To achieve these goals, 4-C has developed these programs: 1) Purchase of Child Care, 2) JTPA Day Care Services, 3) 4-C Nutrition Program, 4) Special Education Program, 5) Learning Resources Center and 6) Day Care Information and Referral Services.

I am speaking today on behalf of all child care programs in Kentucky. The crisis of which I speak, however, is not limited to Kentucky; it is affecting child care facilities in every state: centers, family day care homes, preschools; and programs of every type: profit and non-profit, church, community sponsored and Head Start.

Accessible, affordable day care is essential to our nation's families so that they can work and continue to be productive members of our society. When day care is not affordable for families or available to them, then they are forced to make choices between caring for their families and working.

Last summer, 4-C began receiving calls weekly from area child care programs concerned about liability insurance coverage. The reports documented that insurance coverage was becoming extremely expensive and hard to find. The calls increased throughout the fall, and we began to hear that some programs were unable to locate insurance if they cared for special needs children.

In December, the Kentucky Interim Joint Committee on Banking and Insurance heard testimony about the crisis in child care insurance and appointed a Subcommittee on Day Care Liability Insurance. The Subcommittee requested that a statewide child care insurance survey be conducted to determine the scope of the problem. The Subcommittee wanted data on the claims history in child care beyond the data provided by the insurance industry.

The survey was completed and submitted to the Subcommittee on January 17. Since additional responses were received after this date, I revised the survey to include these responses. I have included the revised survey results in my testimony today. (Attachment #1)

SURVEY RESULTS

The survey collected data from family day care homes, for-profit centers, and non-profit centers. A summary of the total data revealed:

- * 43.3% (383 of 884) of the licensed child care programs in Kentucky responded to the survey. Of those responding, 52.2% (200 of 383) cited significantly increased rates, ranging from 53% to 900%.
- * 41.3% (158 of 383) reported cancellation or non-renewal of their insurance coverage.
- * 25.8% (99 of 383) reported at least one insurance claim in the past 5 years. Of the reported claims (240), 85.4% (205) were under \$300. A total of 93.3% (224) were under \$1,000.
- * 90.8% (205 out of 240) of the claims were accident claims. The balance of the claims were vehicular. No claims for child abuse were reported.
- * Of the different programs, family day care homes reported the fewest claims. Six homes reported 8 claims, all under \$1,000. They also reported the highest premiums - \$40 - \$65 per child of licensed capacity.

- * ~~Non-profit~~ and church-sponsored centers reported the highest number of claims. 41.1% (53 of 129) of the non-profit centers reported 156 claims, of which 94.9% (148 of 156) were under \$1,000. These centers had the least problems in finding insurance and the lowest costs.

In summary, there seemed to be no correlation between the number and amounts of insurance claims filed and the decreased coverage and higher rates now being charged.

* * * *

Today, I would like to address the problems facing the child care industry as identified by the survey. These are major problems which impair the ability of the child care profession to adequately provide quality care for children. We urge the Committee to consider these issues as you proceed with addressing the overall liability insurance crisis.

1. The cost of child care liability insurance in Kentucky has increased between 53% and 900%.

Many child care programs cannot pass increased insurance costs onto the families they serve. Programs serving subsidized families receive a set reimbursement per child. There are no parent fees to increase.

Marginal income families, faced with increased child care fees, are withdrawing their children from the centers and seeking other unregulated child care arrangements.

Child care programs operate on shoestring budgets with 75% of the expenditures allocated to salaries. A large non-profit center in Berea, KY reported that she had eliminated a staff position to pay the cost of her insurance. (Attachment #2) This is precisely what should not be happening to children.

These are some comments from other child care providers who responded to the survey:

Louisville: "Our increased cost for insurance has been equalled by an increased cost to parents for child care: as a result, our excellent staff received only minimal salary increases so as not to burden parents impossibly."

Newport: "I was without insurance for about one month, trying to find

rates I could afford. Our premium increased over 900% in a year. We just cannot afford to pay this amount and stay in business."

Owensboro: "I was very upset when my insurance was cancelled because we have had insurance for 19 years, never had a claim, yet our coverage was cancelled."

2. Current policies contain exclusions which do not cover the program against claims of physical or sexual abuse to children.

Even though national data on child abuse cases documents that only one-half of one percent of child abuse cases happen in child care, insurance companies are excluding this claim from child care policies.

As professionals, child care directors are mandated by law to report suspected incidents of abuse to children. Even though the director may exercise all caution from criminal record checks to adequate supervision and training, an isolated incident could happen. Aren't we putting the professional in the precarious position of knowing that when she reports the incident to authorities, she is not afforded protection from any litigation that may result?

Family day care providers, who usually operate alone are even more vulnerable to accusations, yet are afforded no protection.

3. Companies are refusing to write insurance if the child care program serves special needs children.

Old Louisville Children's Center in Louisville is a Metro United Way center. They care for 55 children, including 5 "special needs" children. In December, they were notified by their insurer that they would not insure these children and the policy would be rewritten to exclude them. Six weeks later, the center found a company willing to write insurance which would cover these children. The cost, however, was \$5,000 - \$1,000 per child for each of the special needs children on top of the already increased cost of regular liability insurance.

I am including a November 30th article from the Louisville Courier-Journal which discusses this problem. (Attachment #3)

4. Homeowners and building insurance policies are being cancelled because of on-site child care facilities, even though separate liability insurance on the child care operation is being carried.

I would like to read excerpts of a letter from a child care owner/operator who lives in Grayson, KY: (Attachment #4)

"I mortgaged our home for enough money to add a day care center onto our home. I had a homeowner's policy, ... but was immediately told they would not renew my policy, because of the children. We had carried this policy for more than 20 years and had never turned in a claim. I have liability insurance on the center, and am trying to get homeowner's coverage; so far no success.

My husband is disabled and this is my means of earning a living for my family... I stated earlier that my home is mortgaged... and they will call in my mortgage if insurance coverage is not properly met by January 15th... The center is state licensed. Please let me hear from you."

Nationally, more family day care homes are being adversely affected by this action because they operate within their own homes.

5. Insurance Companies are establishing underwriting standards for insurability that are far in excess of any state licensing standards which child care programs must currently meet.

The State of Kentucky requires a staffing ratio of one adult for each 6 children under the age of two. However, one of the few companies still writing child care liability insurance requires a 1:3 staffing ratio for children under 2. The same significant differences occur for older children.

One child care program in Louisville wrote:

"We got a call this week and although our insurance is paid through August, unless we reduce our (staff) ratios to one to one in some ages and one teacher to four in others, they may cancel us in 45 days. We can't meet these requirements."

* * * *

In conclusion, the data from the Kentucky child care insurance survey documents that there seems to be little correlation between the rate increases, decreased coverage limits, and the claims history in child care

in Kentucky. We are seeing child care programs that have simply given up and closed. This is important in a state with only 41,215 licensed day care slots, and as of 1980, 187,363 parents in the workforce with children under six.

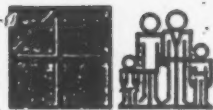
According to the Kentucky Insurance Commissioner's office, Kentucky is not a state attractive to large insurance companies. Compared to other states, the child care business Kentucky can generate is not substantial. The subcommittee studying this problem is concerned that legislation which would require insurance rates based on claims history or would require insurance companies include physical/sexual abuse claims in their coverage would only result in no companies writing this coverage in our state.

Keeping this in mind, the subcommittee studying this crisis is developing a bill that they hope will make Kentucky more attractive to companies insuring child care programs. However, the subcommittee feels that if they introduce legislation favorable to insurance companies, such as capping punitive damages, then the insurance companies should agree to certain provisions such as reasonable rates based on claims experience, and inclusion of coverage of claims against the center for physical/sexual abuse.

We are aware that insurance companies are feeling financial pressures that are forcing them to reevaluate their current policies. They, too, are part of a society that readily turns to litigation; and as you are aware, child care is not the only industry affected.

We do not presume to judge whether the insurance crisis is fueled by speculation or solid evidence; nor do we presume to judge whether judicial reform will result in a more reasonable insurance market. However, we are certain that the real victims of this crisis are the children and their families. They will reap the consequences of fewer child care slots, and increased costs. Whatever additional revenue that increased parent fees will generate will go to paying insurance costs; not to providing additional staff and resources that help assure the safe and healthy development of children in child care.

4-C, as well as other child care organizations throughout the country, offer our assistance as you work to alleviate this current crisis and prevent its inevitable return.



ATTACHMENT NO. 1

Community Coordinated Child Care

1355 South Third Street • Louisville, Kentucky 40208 • (502) 636-1358

KENTUCKY DAY CARE INSURANCE SURVEY

January 17, 1986
(data revised February 14, 1986)

Submitted To:

The Subcommittee on Insurance for Day Care Centers
of the Interim Joint Committee on Banking and Insurance

Representative Gerta Bendl, Chairman

Committee Members:

Representative Ben Handy
Representative Ramsey Morris
Representative Raymond Overstreet

Survey Conducted By:

Community Coordinated Child Care (4-C)
KY Association for Child Care Management (KACCM)
KY Citizens for Child Development (KCCD)

Data Compiled By:

Linda Locks
Community Coordinated Child Care (4-C)

STATEWIDE INSURANCE SURVEY

Combined Summary of Family Day Care, For-Profit and Non-Profit Centers

Response:

Total licensed day care sites in KY ¹ :	884		
Survey responses:	383	(43.3%)	
Licensed For-Profit Centers ¹ :	448	Responses:	160 (35.7%)
Licensed Non-Profit Centers ¹ :	226	Responses:	129 (57.1%)
Licensed Family Day Care Homes ² :	210	Responses:	94 (44.8%)
Respondents reporting problems w/finding a liability insurance carrier:	158	(41.3%)	
cancellations:	37		
non-renewals:	121		

Cost:

Cost data was most often reported in how much premiums had increased, either by dollar amount or by %. Of the total respondents, 200 (52.2%) cited significantly increased rates, ranging from 53% to 900%.

Accessibility:

Respondents that have operated or are currently operating without liability insurance: 23

Six respondents commented that homeowners or building insurance was cancelled because of on-site day care.

A list of insurance companies noted in the responses is included. However, we received calls on a day-to-day basis from day care providers who thought they had no problems and had just received non-renewal notices.

Claims: Other judgments cited - See Note #4.

Total sites reporting at least one insurance claim in past 5 yrs.	99	(25.8% of Respondents)
Total claims reported in past 5 yrs.	240	
Total claims under \$300 :	205	(85.4%)
\$300 - \$1000:	19	(8.0%)
Over \$1000:	7	(3.0%)
Unknown & Pending :	9	(3.7%)

Accident Claims

Number reported in past 5 yrs. :	218	
Total claims under \$300 :	200	(91.7%)
\$300 - \$1000:	7	(3.2%)
Over \$1000:	3	(1.4%)
Number of claims pending :	2	
No. of claims amt. not listed :	6	

Vehicular Claims

Number reported in past 5 yrs :	22	
Total claims under \$300 :	5	(23.8%)
\$300 - \$1000:	12	(57.1%)
Over \$1000:	4	(19.0%)
No. of claims amt. not listed :	1	

STATEWIDE INSURANCE SURVEY

Family Day Care HomesResponse:

Total Family Day Care Homes licensed in KY:	210	
Survey Responses:	94	(44.8%)
Respondents reporting problems in finding a liability insurance carrier:	43	(45.7%)
Cancellations :	10	
Non-Renewals :	33	

Cost:

Number of respondents reporting significantly higher premiums :	48	(51.1%)
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Comments show that many respondents were paying from \$40 - \$65 per child of licensed capacity.

Accessibility:

Respondents that have operated or are currently operating without liability insurance: 9

Two day care homes reported that their homeowners insurance had been cancelled because they operated a day care center in their home.

Claims:

Total homes reporting at least one insurance claim in the past 5 years :	6	(6.5%)
Total claims reported in past 5 years:	8	

Accident Claims - number reported in past 5 years :	8	
Reported claims under \$300 :	7	(87.5%)
\$300 - \$1000:	1	(12.5%)
Over \$1000:	0	

No Vehicular Claims reported.

STATEWIDE INSURANCE SURVEY

For-Profit Centers

Response:

Total For-Profit centers licensed in KY:	448	
Survey Responses:	160	(35.7%)
Respondents reporting problems in finding a liability insurance carrier:	78	(48.8%)
Cancellations :	11	
Non-Renewals :	57	

Cost:

Number of respondents reporting significantly higher premiums :	104	(65%)
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Comments show that many respondents were paying from \$25-55 per child of licensed capacity.

Accessibility:

Centers reporting that they have operated or are currently operating without liability insurance: 11

Four centers commented that they are unable to get building coverage because the building houses a day care center.

Claims:

Total centers reporting at least one insurance claim in the past 5 years :	40	(25%)
Total claims reported in past 5 years:	76	
1 claim pending - 5 claim amounts not listed		
Accident Claims - number reported in past 5 years :	72	
Reported claims under \$300 :	61	(84.7%)
\$300 - \$1000:	4	(5.6%)
Over \$1000:	1	(1.4%)
1 claim pending - 5 claim amounts not listed		

Vehicular Claims - number reported		
in past 5 years	:	4
Reported claims under \$300	:	3 (75%)
\$300 - \$1000:		0
Over \$1000:		1 (25%)

STATEWIDE INSURANCE SURVEY

Non-Profit Centers

Response:

Total Non-Profit centers licensed in KY:	226	
Survey Responses:	129	(57.1%)
Respondents reporting problems in finding		
a liability insurance carrier:	37	(28.7%)
Cancellations	6	
Non-Renewals	31	

Cost:

Number of respondents reporting significantly		
higher premiums	50	(38.8%)

The premiums reported by the Non-Profit sector were somewhat lower than the private sector. The church-sponsored centers seemed to have the least problem in finding insurance and the lowest costs. (See Note #3.)

Accessibility:

Centers reporting that they have operated or are currently		
operating without liability insurance:	3	

Claims:

Total centers reporting at least one insurance claim		
in the past 5 years	53	(41.1%)
Total claims reported in past 5 years:	156	
1 claim pending - 2 claim amount not listed		
Accident Claims - number reported		
in past 5 years	138	
Reported claims under \$300	132	(95.7%)
\$300 - \$1000:	2	(1.5%)
Over \$1000:	2	(1.5%)
1 claim pending - 1 claim amount not listed		
Vehicular Claims - number reported		
in past 5 years	18	
Reported claims under \$300	2	(11.8%)
\$300 - \$1000:	12	(70.6%)
Over \$1000:	3	(17.6%)
1 claim amount not listed		

NOTES

- (1) Data supplied by Jean Cole, Cabinet for Human Resources, Division of Licensing and Regulation. Revised figures of current day care sites are available at the end of January and July of each year. The data used in this survey was compiled as of July, 1985.

July 1985 data listed 1,042 licensed sites in Kentucky. Of these, 158 were Head Start sites and were not counted in the total numbers of sites listed in this survey.

- (2) A family day care home is located in the owner's own home and is licensed for 12 or less children. In Kentucky, these are listed by the Division of Licensing and Regulation as Type II day care facilities.
- (3) We received a call from Old Louisville Children's Center on January 10 updating their plight with the care of special needs children. Their board president, April Kerr stated:

"We are unable to obtain liability coverage for the center at a greatly increased cost. The policy, however, will exclude the five special needs children that we served. We contacted the agent and broker whose name was given to us by the Insurance Commissioner's office as being a company that would consider writing coverage for these children. We've just heard from them. They would require that we maintain our current liability coverage. They would then cover the five special needs children, at a cost of an additional \$5,000. That's \$1,000 a child for each of these children on top of the already increased cost of regular liability insurance."

- (4) Only one response listed knowledge of a judgment awarded against a day care center in their area. This was noted as \$5,000.
- (5) The total claims over \$1,000 (\$56,900) were reported as follows:

Accident Claims over \$1,000:

Family Day Care Homes	-0-
For-Profit Centers	\$ 13,000
Non-Profit Centers	20,000
	\$ 33,000

Vehicular Claims over \$1,000:

Family Day Care Homes	-0-
For-Profit Centers	\$ 2,000
Non-Profit Centers	21,900
	\$ 23,900

Attachment 2

BEREA CHILDREN'S CENTER ASSOC. INC.

P.O. BOX 184 • BEREA, KENTUCKY 40403 • (606) 986-4573

February 14, 1986

Ms. Linda Locke
4-C Attention: Insurance Survey
1355 S. Third Street
Louisville, KY 40208

Dear Ms. Locke:

As the Co-Director of the Berea Children's Center Association (a private non-profit day care center), I am writing to express my concern over the difficulty we are having in obtaining liability insurance at a reasonable cost.

At the present time Insurance Company of North America has informed us they will no longer offer liability coverage to us although we have been covered

by them for several years and have had no claims filed against our policy. Consequently our insurance rate will increase from \$311 annually (which included \$300,000 liability, \$10,000 on the contents of the building, \$1,000 medical, and \$2,500 bond) to \$2,158.00 just for liability coverage. I am told medical coverage for accidents in day care centers is not available from any company.

An increase of this magnitude in an organization that has extremely limited resources places us in a serious dilemma. Young children need as much adult attention and supervision as possible. However, with insurance demands of this size, our only alternative will be to lower the staff ratio in order to pay the insurance which is being purchased to protect the children. With less staff the quality of care is lessened and the probability of mishap increases. I feel our children are our most valuable resource and deserve better attention than this.

Of the children in our care, 46% qualify for some fee assistance to cover the cost of care. All of our parents are working parents with an average annual income of \$17,500. To raise fees to cover the increase in liability insurance is not the answer and avoids the issue. Are we as a society going to provide quality child care which will insure the development of healthy children and productive adults? What is really at issue is the kind of society we hope to have in the years ahead.

If there is any way I can help in working on this problem please do not hesitate to contact me.

Sincerely,

Annette Stolz

Annette Stolz, Co-Director

Louisville, Ky., Saturday morning, November 30, 1985

Child-care centers face crisis as insurance costs skyrocket

By MIKE KING

Staff Writer

Theresa Hibbard is a housekeeper for the Seibach Hotel. Her husband, Ed, makes boxes at the Dayton Wire Co.

"We aren't wealthy people," she says. "We can't afford a baby sitter."

Until a week ago, the Hibbards' 18-month-old son, Danny, was enrolled with other infants at the Old Louisville Children's Center, 523 Ark Avenue. Not any more.

Danny has a condition known as apnea — a temporary, unexplained cessation of breathing. Because apnea is thought to be a leading cause of Sudden Infant Death Syndrome, Danny must be attached to a small monitor while he sleeps. Like Danny's parents, caretakers at the Old Louisville center had been trained to use the monitor and to provide CPR (cardiopulmonary resuscitation) when needed.

His pediatrician believes Danny will need to use the monitor for a few more months, but now his parents have no place to take him while they work.

Danny Hibbard and his parents are among the local victims of a new crisis facing American child-care centers.

Day-care operators — those who care large numbers of children in centers and those who run licensed

"family day-care" centers in homes — are being hit by skyrocketing premiums for liability insurance that threaten their survival.

The most vulnerable centers are those like Old Louisville, which made a commitment months ago to care for special children like Danny Hibbard.

"It made us sick, having to tell the Hibbards that Danny would have to leave," said Shannon Delahunty, the center's director. "But we essentially got an ultimatum from our insurance carrier: Either get rid of the special-needs children or have no liability coverage."

Since Old Louisville was closed to Danny, the Hibbards, with the help of the Council for Retarded Citizens of Jefferson County and Community Coordinated Child Care — an advocacy group that represents day-care operators — have been hustling to try to find a place for him.

So far they have had no luck.

"It has been very frustrating. All of the centers are in the same predicament: If they accept a high-risk child, they could really run into difficulty with their (insurance) carriers," said Linda Lacke, advocacy coordinator for the child-care group. "The rates are already getting prohibitive at some centers. If ... (the operators of the centers) did this (accepted special-needs children,

they would probably refuse to write a liability policy."

The Hibbards aren't alone.

Earlier this month, the Iroquois Child Care Center at 4100 Lenix Ave. had to dismiss a child who needed an apnea monitor because its insurance carrier wouldn't issue a policy while the child was in the center. Ruth Anderson, the center's director, said the situation has jeopardized her center's commitment to care for special-needs children.

"Our experience has been that the handicapped children, when placed in a normal setting, learn from being around normal children, and vice versa," she said. "But now we are being told that these kids, who really aren't all that handicapped, can't stay with us."

The problem is serious, said Dr. John Roberts, a neurologist whose daughter was on an apnea monitor.

Child-care centers face insurance crisis

turns on investments — have begun tightening their belts by "selling proper and reasonable rates based solely on what it feels is its exposure to liability," she said.

"I think we have an education job to do," he said. "These children can be cared for in a group situation without significant risks."

As a result, liability insurance for "public-exposure" clients, such as restaurants, schools and theaters, is much more expensive than it was just two years ago, she said.

Day-care centers, which have been hit by a rash of negligence lawsuits resulting from allegations of sexual abuse and exploitation, have been among the hardest hit.

"The incidence (of successful litigation) is actually pretty rare, and confined mostly to California, but some of the awards have been fairly large," Musseiman said. "But there is no question they tainted the minds of the underwriters."

Some centers have lost their insurance altogether.

In August, Shirley Hanking, the owner of the Children's Center, a home-care center that serves nine children in Cave City, was told that her insurance carrier was revoking the center's liability coverage. She had been paying \$156 a year. The only companies willing to insure her business now, she said, want \$500 a

year, which would force her to double her fees.

"And my parents just can't afford that," she said. "I'd go out of business."

The premiums quoted to Mrs. Hanking aren't out of line with national averages, according to a survey by the National Association for the Education of Young Children. In larger centers, the rates average \$45 to \$50 per child per year, the association said, compared with \$15 to \$20, two years ago.

The situation is the same in Indiana, according to Carol Corley, president of the Indiana Licensed Child Care Association. Last summer, she said, the association surveyed its 527 members and learned about rate increases ranging from 130 percent to 400 percent.

"At this point, the only centers that don't appear to be vulnerable are those attached to churches or other organizations who are covered by an umbrella plan of some kind," she said.

"But we've been warning our church centers to be watchful. As the insurance companies become aware there is a child-care center on the property, they start jacking up the rates. It is a terrible situation."

December 27, 1985

Community Coordinated Child Care
1355 South Third Street
Louisville, KY 40208

Attention Day Care Insurance Survey

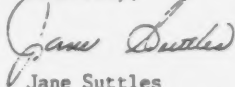
Dear Sir:

In regard to your letter and survey on Day Care liability insurance, I would certainly appreciate some help. I mortgaged our home for enough money to add a day care center on to our home. I had a home owner's policy with Nationwide, immediately they told me they would not renew my policy, because of the children. We had carried this policy for more than twenty years and had never turned in a claim. I finally got a home owner's policy with Farm Bureau, I am sending you a copy of the letter I received from them stating that they would not renew my policy but not why. I talked to my local agent and he indicated in the conversation that he had known that the policy would not be renewed, but I was given a short notice. I have liability insurance on the center with W.E. Kingsley Co., I am also enclosing the cover sheet from that policy. Grayson Insurance Co. helped me get this policy and are now trying to help me find another home owner's policy, so far no success.

My husband is disabled and this is my means of earning a living for my family. I stated earlier that my home is mortgaged and Farm Bureau has also notified the bank that they will not renew the policy and they will call in the mortgage if insurance coverage is not properly met. I don't know why I need two policies but apparently I do. The home owner's policy and the liability policy both expire January 15, 1986. I will be renewing my liability insurance with Kingsley, but I am desperate about the home owner's policy. If there is any way I could get some help it would be appreciated, but I only have until January 15, 1986 to take care of this matter.

The center is state licensed and has a capacity of twenty children.
Please let me hear from you.

Thank you
Sincerely,



Jane Suttles
Director
"Janie's Baby School"

lks

Enclosures

Senator McCONNELL. Thank you, Ms. Locke. As you indicate, you are not taking a position on any particular approach to solving the problem, but rather outlining the significance of it. And just to recap a couple of the things you said, you indicated that 41 percent of the child care providers in Kentucky reported that their liability insurance has been canceled or not renewed in recent months.

Ms. LOCKE. That is correct.

Senator McCONNELL. What are these providers going to do?

Ms. LOCKE. Well, at this point in time we have spent a lot of money within 4-C to try and contact them if there was any way through the survey, by postmark or whatever, to call and let them know they can call the insurance commissioner's office. He is helping them to find insurance. However, we did find a significant number that are, as the terminology seems to be, bare.

Senator McCONNELL. Are going to go out of business?

Ms. LOCKE. Yes.

Senator McCONNELL. If they close their doors, then the consequences for our society are pretty enormous.

Ms. LOCKE. Especially in Kentucky, because we have so little licensed day care compared to the need for it.

Senator McCONNELL. Senator Simon has joined us. Senator, do you have an opening statement or any questions for Ms. Locke?

OPENING STATEMENT OF SENATOR PAUL SIMON

Senator SIMON. I wish to commend you for having the hearings. This is a major problem in every area—child care, rollerskating rinks, physicians, hospitals.

I testified yesterday before the Commerce Committee. I met last week with the officers of a major corporation in my State where their liability insurance for the board of directors—and I recognize, this is a large corporation—last year their liability insurance for the board of directors was \$125,000. This year it is over \$5 million—you know, just astronomical increases. The board of trustees of one of the largest universities in our State, their insurance has gone up 2,000 percent.

What is interesting—and I was fascinated to read your testimony—you say there seem to be no correlation between the number and amounts of insurance claims filed and the decreased coverage of the higher rates now being charged, and that is what I find much too consistently as I look in various areas.

Also it is interesting that you say nonprofit and church-sponsored centers report the highest number of claims, 41 percent of the nonprofit centers reported 156 claims, of which 94 percent were under \$1,000, and yet these centers have the least problem in finding insurance and the lowest cost. So there is just no rationality to this.

I hope that one of the things that we will look at in the Judiciary Committee is noncourt remedies for problems so that we can reduce some litigation. I think that is part of it.

Senator McCONNELL. Well, we are going to have some insurance people here that can address some of these questions, too.

Senator SIMON. Unfortunately, I am going to have to take off very shortly because of another meeting. Let me just add—and I

hope you will ask the insurance people about this—I think they tend to be opposed, although I am pleased to say that one outstanding insurance company in my State supports this concept—I think modification of the McCarran-Ferguson antitrust exemption for insurance companies is overdue.

It was put on without a vote of either the House or the Senate, it was put on in a conference committee, and you and I know how those things can happen. I recognize that I am fighting powerful forces when I say we ought to modify that, but I just think we have to recognize that, while they should be able to share risk information, they should not be able to get together and say we are going to charge so much for insurance or we are not going to insure certain risks or certain groups. They should not be able to do that, any more than any other business should be able to. The free enterprise system is healthy when it is competitive, and we ought to make sure that competition stays.

That is by no means the only answer to this problem, but it is just one piece of the puzzle but I think it is an important piece of this puzzle.

Again, I commend you and I commend my neighbor from south of Illinois, Kentucky. I appreciate your testimony and I think it underscores precisely what the problem is.

Thank you.

Senator McCONNELL. Senator Simon, thank you for coming. And I might say, in response to some of your suggestions, that I think the insurance industry needs to be a bit more forthcoming with information than they have been. I am told to date before the Commerce Committee about just what portion of this problem is not attributable to the court system and the two bills that I have introduced deal with the court system and I am convinced that is a big part of the problem, but I am also interested in knowing some figures from the insurance industry about their profitability and we have got some witnesses from that industry coming up and I will try to ask the questions you would have had you been here.

Senator SIMON. And if you can, for the insurance representatives who are here, I would like in writing a response to the testimony by Linda Locke. I think she raises some important questions and I would like to have the answer as to how we end up with this absolutely irrational set of rates in the day care industry. I just cite this one, and unfortunately there are all kinds of other examples that could be provided.

Thank you, Mr. Chairman.

Senator McCONNELL. Thank you, Senator Simon.

Thank you, Ms. Locke.

Ms. LOCKE. Thank you.

Senator McCONNELL. Our next witness is Jay Angoff, counsel to the National Insurance Consumer Organization.

STATEMENT OF JAY ANGOFF, COUNSEL, NATIONAL INSURANCE CONSUMER ORGANIZATION

Mr. ANGOFF. Good morning, Mr. Chairman and Senator Simon. I appreciate very much your invitation to testify here today. I am counsel to the National Insurance Consumer Organization. This is

a small consumer nonprofit group that was set up in 1980 by Bob Hunter. Bob Hunter worked in the insurance industry for 10 or 12 years and then was Federal Insurance Administrator under both Presidents Ford and Carter, and in 1980 he set up our group.

I guess I would like to start off with some things about which we agree, because there are many things said here to which we agree.

When you talk about the legal system being overcrowded, about the long delays, about the inefficiencies, that is something that we are also concerned with and we strongly support efforts to make the system more efficient, to reduce some of these transaction costs, therefore we strongly support things like alternative dispute resolution, arbitration, mediation, no-fault systems for small claims, where the deterrent and disclosure functions of the tort system are not as important, and in that context with respect to what you said about your work in local government, I think that really—and that is what studies have shown—that is where the real problem is, not with the big claims, it is with the small claims. I do not know that I would necessarily use the word "frivolous," but studies have shown that people who bring small claims are overcompensated, and that if there is some thing we could do to reduce those costs, that is something that we strongly support.

There are things we can do on one side to reduce frivolous motion defenses to objections and on the other side frivolous suits, if there is something we can do to reduce legal costs both for the plaintiffs and defendants, that is something we support.

I should mention that legal defense costs have risen probably faster than anything else in this debate. For example, an insurance study last year said that in the past 25 years legal defense costs have risen three times as fast as the amount that insurance companies actually pay out to victims, and there are predictions that by 1990 half of what insurance companies pay out will go to the legal defense team.

Senator McCONNELL. Whose study was that?

Mr. ANGOFF. This was done by the Insurance Services Office and the National Association of Independent Insurers, and it is called "1985: A Critical Year," and I commend it highly.

So those types of things to make the legal system more efficient, those are things we support. On the other hand, we respectfully oppose suggestions to limit the ability to recover because we think what you are doing in that case is hurting the people who have already been hurt the most and can least afford to be hurt again. For example—I just want to give you a few examples—to cap pain and suffering at \$100,000, what that means is, say, a woman, because her mother took DES, she gets vaginal cancer, she has a hysterectomy, she has two-thirds of her vagina removed so she cannot have kids, she cannot have sex, but she can still work and the operation really is not that expensive, so she has got very little net economic loss, but I think most of us would agree that \$100,000 is relatively small compensation for someone who has had that type of loss.

Or let us say a man who has both his legs amputated, again that is a relatively inexpensive operation, but if he has got a desk job he can still work, he has very little out of pocket loss, but again I think \$100,000, his pain and suffering is certainly worth more than \$100,000.

I do not minimize the argument that pain and suffering is a difficult concept to get a hold of and that juries will award, in different cases they will award different people amounts, but I do not think you solve the problem by just arbitrarily saying that no injury, no matter how severe, is worth more than \$100,000.

Senator McCONNELL. You do not think awards of damages through the pain and suffering approach have been abused?

Mr. ANGOFF. I am sorry?

Senator McCONNELL. You do not think the pain and suffering awards, for damages for pain and suffering, you do not see any particular abuse there?

Mr. ANGOFF. No, I do not see an abuse in pain and suffering. I do see that there are some cases such that I would agree are frivolous and I frankly see more abuse among the small claims that one can very easily argue are filed for their nuisance value.

I guess I have got to say when I hear talk about a lottery, I mean the implication seems to be that people go out and deliberately have brain damaged babies or contract vaginal cancer in order to get these big awards, if you really look at the cases—and I do not doubt that there are—mean obviously the system is not perfect, there are certainly big awards I would disagree with, but by and large the cases that get the large awards are the very, very severe injuries. But we do support anything that can make the system more efficient, that can reduce delay, we are strongly in favor of and we hope we can work with it.

I think you have also got to look at the insurance industry. If you read the trade press, not a week goes by that an insurance executive says, sure, we are for court reform and that is part of the problem but also we have got to look at our own industry. I mean there is no question but that the industry is cyclical. If there was a similar crisis in 1975 with the same arguments being made, because in 1975, just as today in 1986, interest rates are very low and perhaps that is due to the President's economic program. Interest rates are very low and so insurance companies make a relatively small amount on the premiums they invest.

On the other hand, in 1980, when interest rates were around 20 percent, insurance companies made a lot of money on the premiums that they collected and then invested, so what they did was cut their prices and then insure some bad risks that they should not have insured just to get the premium dollars to put in the bank and make 20 percent on.

So what you have now is a situation where there is really a double whammy. On the one hand, they are paying out for some of the losses that they probably should not have insured a few years ago when the rates were 20 percent, and on the other hand they are making very little, relatively little on the premiums that they are collecting today, so they are not in a loss position but they are making less than they did, say, in 1980.

I guess our concern is that there are certain exemptions from Federal laws that the insurance industry has enjoyed which may be justified but that really have not been examined very carefully, and I would just like to go through a few of them.

The first is, as Senator Simon pointed out, the McCarran-Ferguson exemption from the antitrust laws. A number of committees

and commissions have examined this—the National Commission for the Reform of Antitrust Laws and Procedures in 1979, prior Justice Department studies. I might also mention that Jim Miller, former Chairman at the FTC, now, of course, Director of OMB, has also gone on record in this way and they all agree that the McCarran-Ferguson exemption is unjustified and I just think that should be looked at very carefully and that this committee and Congress in general should make a decision as to whether that should be retained.

Now, the other thing, Mr. Chairman, that makes this industry unique is that it is also totally exempt from Federal regulation. In other industries, other industries have been partially exempted from the antitrust laws in the past, such as trucking and railroads, but what we do or what Congress does in those cases is to substitute for a competitive regime a regulatory regime, that is, a Federal regulatory system, that the insurance industry is totally exempt from Federal rate regulation, too, and, third, it is exempt from Federal consumer protection regulation.

In 1979, the FTC did a study which concluded that part of the life insurance industry was not a good—certain types of life insurance were not a good value for consumers and after that Congress attached a rider to the FTC authorization bill prohibiting the FTC from even studying the industry.

I should say also that Jim Miller has gone on record opposing that exemption and in favor of subjecting the industry to the antitrust laws, both the antitrust laws and Federal Trade Commission consumer protection scrutiny.

Finally, this industry is exempt from Federal taxes. The GAO did a study last year in which they found that between 1975 and 1984, the property casualty insurance industry as a whole had net gains of \$75 billion yet paid no Federal income tax and in fact got a \$125 million tax refund. Now, the reason I mention that is just—I mean there may be reasons to retain that exemption, but the reason I mention that is just to illustrate that the profit and loss figures that the insurance industry releases are accurate, given that there are certain accounting conventions that currently exist, but that those accounting conventions which allow an industry to make a substantial profit yet pay no tax may be something that you want to look at.

And then the fifth thing is this: There are State laws that prohibit people or make it very tough for people, for businesses, manufacturers and others to self-insure, that is to band together as a group or else to pool their buying power and to buy insurance as a group.

Now, in 1981 Congress passed the Risk Retention Act which pre-empts those laws as to manufacturers but only manufacturers. It does not help day care centers or nurse midwives, for example. I think that there is substantial support for expanding the Risk Retention Act so that it does cover day care centers and nurse midwives and other businesses so that those people can self-insure or buy insurance at a lower rate.

So these are all areas that I think should be looked at and I guess I would like to conclude by just suggesting a four-step analysis which should be gone through in considering tort reform.

The first step is to find out—and unfortunately we do not have this data, only the insurance industry has this data—find out how much money the insurance industry pays out and how much it takes in year by year, line by line, and State by State.

Now, there may well be lines where there is a problem. There may well be lines where insurance companies are paying out dramatically more, but I have seen examples where they are not paying out more, they are paying out less. New Hampshire, for example, there is no crisis, losses have gone down, it is a very conservative State, there have been \$2 million-plus verdicts in the history of the State, yet people in New Hampshire are having the same problem in getting insurance as in more litigious States. I think you heard some examples—Mr. Chairman, you mentioned some examples yourself of instances where companies have no claims at all and where the liability doctrine in the State just is not expanding, if anything it is contracting, so there is no justification, that is, neither the claims experience nor the individual insured nor court decision in the State would justify a 500-percent increase in premiums or a refusal to insure, so I think that is the first step, you have got to get the data on how much they paid out.

The second step is just to find out why they are paying out more. Now, it may be that claims have increased, losses have increased, court decisions have expanded liability, but it may also be that companies or municipalities are being more negligent or it may be that there are things that the insured could do, that the insured is doing that should not be doing and it can be improved.

The third step is this, to take a look and see if the data suggests that limiting liability would bring down insurance rates, and there is admittedly very little data on this, but the studies so far indicate that they would not.

For example, there was a study done by a Frank Sloan, an economics professor at Vanderbilt, it is in volume 9 of the "Duke Journal of Health Politics, Winter 1985," and in that he analyzes the limits on liability that were imposed in the midseventies and he finds that there was no effect on the premiums as a result of those reforms.

In addition, there is the Ontario, CA, experience. Ontario has in its law today most of the things that are being proposed in the States today, that is caps on pain and suffering, no punitive damages, no contingency fees, no add damnam clause, the loser pays the winner's attorneys fees, and the jury is much less active, so that would also—and there, despite those very restrictive doctrines, rates have not gone down, meaning insurance rates are still going up, people recover less money but insurance rates are still going up. The city of Toronto, for example, cannot get insurance and day care centers cannot get insurance.

The fourth step though is the most important and that is you have got to make public policy choices of whether the costs of the system justify its benefits. We have heard a lot about the costs of the system and, while I might disagree about where the costs lie, I do not disagree that the system is a costly system. I think you have also got to consider the benefits, you have got to consider not just compensation but also deterrents and disclosure.

It was lawsuits that got asbestos off the market, that uncovered the asbestos scandal and got asbestos off the market and it now saves lives. It was lawsuits that uncovered the fact that Ford, when they made the Pinto, did a cost benefit analysis and concluded that they were not going to make an \$11 per car improvement because that was more expensive than saving 180 lives and averting 280 serious burn injuries.

It got the Dalkon Shield recalled, and I will go into details about that. The only point is that the benefits of the system we have should also be considered as well as the costs when we consider tort reform.

Mr. Chairman, thank you very much and I will be glad to answer any questions.

[The prepared statement of Mr. Angoff follows:]

TESTIMONY OF

JAY ANSOFF
COUNSEL

NATIONAL INSURANCE CONSUMER ORGANIZATION

Mr. Chairman and Members of the Committee:

The National Insurance Consumer Organization is grateful for the opportunity to testify on practices of the insurance industry, and laws and regulations relating to the insurance industry, that may have contributed to the sharp premium increases and refusals to deal in the insurance market that we are seeing today.

I. Data Collection

The first step in determining the cause or causes of premium increases and refusals to deal is to get the data. Specifically, this Committee should invite the property/casualty insurance industry to disclose the number of claims paid, and the average size of those claims, year by year, line by line, and state by state. It may be that for some lines, and in some states, the number and size of claims paid has dramatically increased in recent years, thus indicating that non-insurance industry factors may be in part responsible for insurance industry increases and refusals to deal. On the other hand, the number and size of claims paid may not have increased dramatically, thus pointing to internal property/casualty industry factors as the cause of such increases and refusals.

The point is that legislators must have the data in order to begin to assign responsibility for the current conditions in the insurance market.

II. Exemptions from Federal Law

Second, this Committee should determine the extent, if any, to which the following privileges of the insurance industry have contributed to sharp premium increases and refusals to deal:

1. The insurance industry's exemption from the antitrust laws under the McCarran-Ferguson Act. Insurance companies can legally raise their prices in concert without fear of antitrust prosecution. Executives in other industries who raise prices in concert can go to jail for three years.

2. The insurance industry's exemption from federal rate regulation. Congress has on occasion exempted other industries, such as trucking and railroads from the antitrust laws, but has substituted federal rate regulation for antitrust enforcement as a means of keeping rates down. The insurance industry is unique in being exempt from both antitrust enforcement and federal rate regulation.

3. The insurance industry's exemption from federal consumer protection regulation. Insurance companies can engage in unfair or deceptive trade practices without fear of Federal Trade Commission prosecution. In addition, in 1979, after the FTC published a study critical of whole life insurance, Congress prohibited the FTC from even studying the insurance industry.

4. The property/casualty insurance industry's exemption from federal taxation. According to an October, 1985, U.S. General Accounting Office study, the property/casualty insurance industry had net gains of \$75.2 billion during the period 1975-1984, yet paid no federal income tax and in addition received a \$125 million tax refund from the government. 1/

There may be legitimate reasons for some or all of the above exemptions. Our only point is that Congress should examine these exemptions to determine whether, and to what extent, they may facilitate sharp premium increases and refusals to deal.

III. State Regulation

Since the federal government can neither regulate nor monitor the insurance industry, and since private individuals may not sue insurance companies for price-fixing under the antitrust laws, the only entities with the authority to control insurance company practices are the state insurance commissions or departments. Both the willingness and ability of state insurance commissions to meaningfully regulate the industry have been questioned. In 1979, for example, the GAO found that "there are serious shortcomings in state laws and regulatory activities with respect to protecting the interests of insurance consumers in the United States." Specifically, the GAO found:

a. "most states do not have specialized examiners and few states have the capacity to do computerized audits";

b. "the authority of departments to order corrective action is very limited";

c. "the degree of scrutiny given important premium increase requests varies among the states. Among those [17 states] GAO examined, only Texas and Massachusetts conducted an original actuarial analysis enabling them to independently recommend the appropriate level of insurance rates";

1/ See U.S. General Accounting Office, Tax Administration: Information on How the Property/Casualty Insurance Industry is Taxed (October 1985).

d. "insurance regulation is not characterized by an arms-length relationship between the regulators and the regulated";

e. "in general, the number of individuals on insurance department staffs with relevant professional training is small." 2/

NICO believes that this Committee should determine for itself whether state insurance commissions are willing and able to meaningfully regulate the industry. It should also determine the extent, if any, to which the following state laws may have contributed to skyrocketing rates and refusals to deal:

1. State statutes or regulations that prevent or discourage businesses, consumers and municipalities from joining together to buy insurance as a group or to self insure;
2. State statutes or regulations that prevent banks and other financial institutions from selling insurance;
3. State statutes or regulations that permit rate increases to take effect without being approved by the state regulator;
4. State statutes or regulations that permit insurance companies to set rates without taking into consideration the past claims experience of the insured;
5. State statutes or regulations that permit mid-term cancellations or refusals to renew without notice.

Legitimate reasons may exist for protective state regulation for the insurance industry, just as legitimate reasons may exist for exemptions from federal law for the insurance industry. Congress should very carefully examine such exemptions and protections, however, to determine their effects.

IV. The Cyclical Nature of the Insurance Industry

The insurance industry is cyclical, as indicated by Chart I, attached as Exhibit A. Insurance companies cut their premiums and insure bad risks when interest rates are high, in order to get more premium dollars to invest; they raise their premiums when interest rates are low, and must raise them even higher when they must pay off on some of the risks that they unwisely insured during the high interest rate years.

In 1981, for example, with both interest rates and their rate of return at about 20%, insurers were "begging for business, at any price, to get premium dollars to invest," according to the president of a large New York insurance

brokerage. 3/ Insurers even wrote policies for those harmed in the Las Vegas MGM Grand Hotel fire — after the disaster occurred. 4/ They believed they would earn more by investing their premiums immediately than they would lose by paying out claims in the future. (Had insurers not cut premiums after 1980, but had merely held them constant, their rate of return both between 1981 and 1983 and for the period 1976-1983 would have been at least 30%. See Exhibit B.)

Today, on the other hand, interest rates have declined. The industry finds itself paying claims on policies that were written back in the days of hyperinflation, when its rates were too low. So, just as it did in 1976, during the last insurance cycle bottom, the industry substantially raised rates — by an average of 72% for general liability policies — 5/ and reduced coverage.

Attached as Exhibit C are several quite candid comments of high level insurance executives about the "inevitability" of the insurance industry cycle and the "overreaction" of the industry to competitive pressures (see comments by CNA chairman Noha), the "almost total disregard for pricing adequacy and risk retention" by insurance companies in recent years (see comments by Atlantic Companies president Trowbridge), and "basic greed of new-found capital" in the insurance industry (see comments of Hartford president Frahe). This Committee should consider whether there are actions Congress could take to counteract the above problem. It should also determine the extent to which the industry's exemption from federal law and protection under state law may have exacerbated the insurance industry cycle.

V. The Financial Condition of the Property/Casualty Industry

While the insurance industry's profitability may rise and fall, insurance industry stocks just keep on rising: since 1975 the property/casualty stock index has risen about

2/ See U.S. General Accounting Office, Issues and Needed Improvements to State Regulation of the Insurance Business (October 1979).

3/ "Taming the Insurance Industry's Booms and Busts," The New York Times, October 20, 1985.

4/ Id.

5/ Best's Insurance Management Reports, Release No. 31, December 30, 1985, at 9.

500%, while the Dow Jones industrial average did not even double. And during 1985, as insurers tripled and quadrupled premiums and reduced coverage, the property/casualty index rose by 50%, about twice the rise in the Dow. (See Chart II, attached as Exhibit D.)

Perhaps the most apt characterization of the property/casualty industry's financial health appeared in the January 24, 1986 National Underwriter (at 2). Said Thomas K. Meakin, NU's resident expert on the financial health of the industry, under the headline "1985 A YEAR OF GLITTERING GLORY":

"It was acres and acres of diamonds for owners of insurance stocks and financial services issues as our favorites sparkled in 1985 as they seldom have before — if ever. It was a ball, a celebration we'll savor and not forget any time soon. Unless of course 1986 turns out to be just as good or even better than last year! (Forgive me — I'm only dreaming because the new year is off to such a good start)."

VI. Insurance Industry Accounting Methods

In a March, 1985 report entitled "Congress Should Consider Changing Federal Taxation of the Property/Casualty Insurance Industry," the General Accounting Office found that three special property/casualty insurance industry accounting conventions enable the industry to dramatically understate its taxable income. As a result of these conventions, the industry has net gains but pays no tax year after year. See October, 1985 GAO report cited in Note 1. ^{6/}

The most important of these conventions — the loss reserve deduction — permits property/casualty companies to take a deduction in the tax year both for the amount they pay out in claims in the tax year and the amount they estimate they will pay out in claims in the future. This amount is often wildly overestimated; moreover, the insurance company invests and earns income on the amount it estimates it will pay out in the future, and neither the amount deducted nor

^{6/} The members of this Committee who also sit on the Finance Committee say want to examine the non-taxation of the property/casualty industry in considering tax reform this year.

the investment income earned thereon is ever taxed. When the property/casualty industry says it had an underwriting loss in 1985, therefore, that does not mean that it paid out in 1985 more than it took in in 1985; rather, it means that it claims it will eventually pay out -- over, say, the next eight or ten years -- more than it took in in 1985. Left out of the calculation is the investment income the industry earns over the next eight or ten years on what it takes in in 1985; the time value of money is ignored.

VII. Other Factors Possibly Contributing to Premium Increases and Refusals to Deal

While the available data demonstrate that limiting compensation for severely injured people -- which regrettably some have suggested -- does not bring down insurance rates, Z/ making our legal system more efficient might well have such an effect. Exhibit F is a list of 10 legal reforms which NICO believes could make the legal system more efficient and could contribute to lowering insurance rates.

Similarly, better risk management by businesses and better self-discipline by professionals could reduce the incidence of claims and thus lower insurance rates. B/

VIII. Conclusion

The American legal system has received extensive scrutiny by state and federal legislators, the press and the public during the past several years. Doctors, lawyers and other professionals who are negligent, and manufacturers who make defective products, have also received substantial scrutiny in recent years.

The insurance industry, on the other hand, has received virtually no scrutiny by legislators, the press or the

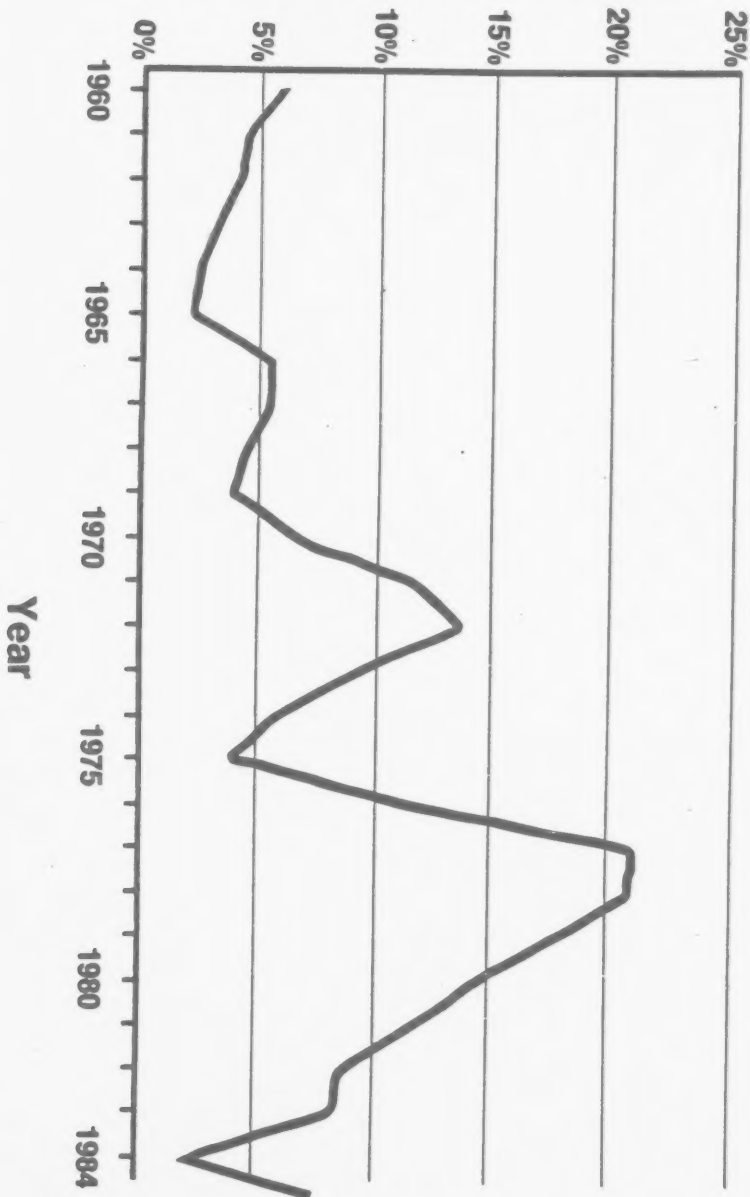
Z/ See, e.g., Sloan, State Responses to the Malpractice "Crisis" of the 1970's: An Empirical Assessment, 9 Journal of Health Politics, Policy and Law 629 (Winter, 1985) ("The empirical results of the study presented here give no indication that individual state legislative action, or action taken collectively, had their intended effect on premiums.") See also Exhibit E (refusals to deal prevalent in Canada despite restrictive tort law).

B/ See, e.g., Public Citizen's Health Research Group, "Medical Malpractice: The Need for Disciplinary Reform, Not Tort Reform," August 27, 1985, and studies therein cited (unanimously concluding that doctor discipline is inadequate).

public. This Committee is to be congratulated on beginning an examination of the conditions in and practices of the property/casualty insurance industry. NICD urges this Committee to carefully analyze the contribution of insurers, insureds and the legal system to periodic refusals to deal and sharp premium increases in the insurance industry and to develop legislation that will prevent such increases and refusals, now and in the future.

Total Return on Net Worth

CHART 1



Ex. A

THE INSURANCE INDUSTRY CYCLE

E.L. B

PROPERTY/CASUALTY INDUSTRY PERFORMANCE, 1976-1983

All Property/Casualty Operations

Year	Earned Premiums	Rate of Return
1976	\$ 56.2 B	14%
1977	68.8	22
1978	79.6	18
1979	89.1	16
1980	95.3	16
1981	97.1	14
1982	102.9	9
1983	107.6	8
Average		15%

Commercial Liability

Year	Earned Premiums	Rate of Return
1976	\$4.2 B	27%
1977	5.9	39
1978	7.3	27
1979	7.9	26
1980(*)	8.0	23
1981	7.4	15
1982	6.6	3
1983	6.7	-2
Average		19%

Source: National Association of Insurance Commissioners Report on Profitability, by Line, by State.

Rate of return calculated by multiplying operating profit, as reported by NAIC, by 2, and then adding in investment income on surplus at an assumed after-tax yield as follows: 1976, 5.0%; 1977, 5.5%; 1978, 6.0%; 1979, 6.5%; 1980, 7.0%; 1981, 7.5%; 1982, 8.0%; 1983, 8.5%.

(*) Note: Had p/c insurers not cut premiums after 1980 but had merely held them constant, their rate of return on net worth would have been:

1981: 29% 1982: 37% 1983: 31% 8-year averages: 30%

Property/Casualty Executives Speak Out

In the wake of the first year on record in which investment income failed to offset the industry's staggering underwriting loss, property/casualty insurers are immersed in the difficult task of effecting a recovery—a task complicated by the specter of financial services deregulation and concern about the possibility of a prolonged capacity shortage, and other problems.

A great deal of commentary has appeared in the trade press about how property/casualty insurers can extricate themselves from their current difficulties and how long this process is likely to take, given the price increases already instituted in the ailing commercial lines sector. To find out how property/casualty executives themselves feel about the issues confronting the industry, *Best's Review* sent a list of questions compiled by our editorial staff to a cross section of insurers, large and small, stock and mutual, in various sections of the country. Thirty-four executives were invited to participate, and 15 responded. All of the replies are included here; in the few instances where a reply is missing, it means that the executive chose not to respond to that particular question.

Last year, the property/casualty industry posted the worst underwriting loss in its history. How long will it take for insurers to achieve underwriting stability?

William O. Bailey
President
Aetna Life and Casualty Co.
Hartford

Cyclicality reflects the course of the economy and the competitive nature of the property/casualty insurance industry. We don't believe it will ever be possible to achieve complete underwriting stability. Underwriting results will improve in 1986 and further improve in 1987 and 1988, but the cyclicality that is ingrained in the business will not disappear.

Edward K. Trowbridge
President
The Atlantic Companies
New York

The consensus in the industry seems to be that 1985 will be the "turn-

around" year—with an operating result roughly equivalent to that of 1984. The significant difference is that 1985 will show an improving trend.

If underwriting stability can be equated with a satisfactory return on capital, we believe it will be 1987 at the earliest before we have achieved such "stability." This projection is based on expected average rate increases of 20% over the next two years, with increases at a much greater rate in commercial than in personal lines. The projection also assumes no significant changes in interest rates or in the value of equity investments.

One additional note of uncertainty is the level of adequacy of loss reserves. Estimates are that industry reserves are as much as 10% to 15% inadequate. If this is correct, it may well delay the return to underwriting stability by as much as another year.

Robert B. Morgan
President
Cincinnati Insurance Co.
Cincinnati

If underwriting stability is defined as underwriting profitability, 1986 has a shot, but it probably still will not occur until 1987. There is not a chance that underwriting stability—over a period of years—is feasible. Supply and demand in the insurance business always seem to be "too much" or "in short supply."

Edward J. Noha
Chairman and Chief Executive Officer
CNA Insurance Companies
Chicago

The property/casualty industry traditionally has experienced significant



GARY L. COUNTRYMAN

cant underwriting or business cycles, the duration and severity of which have varied, but whose inevitability appears to remain constant. The current cycle has been particularly severe, but many companies appear finally to be reacting in the traditional ways, that is, by raising rates, instituting more selective underwriting criteria, restricting new business, getting out of certain lines of business, and attempting to beef up surplus in any way possible. Companies with a strong financial base will not have to take severe actions, but there are others which will have to use all possible steps to improve their situation.

Just as it was very difficult to predict how long it would take for property/casualty companies to begin to react to increasing underwriting losses due

to the complex set of factors at work, it is also difficult to determine now how long it will take until companies again begin the competitive push for more production.

John Bretherick Jr.
President
Continental Corp.
New York

Certainly, some insurers will achieve underwriting stability sooner than others. Those able to recover most quickly will be insurers that have streamlined operations, strengthened underwriting standards, refined their producer network, increased prices and have the capital to take advantage of the tightening market. However, six years of damage cannot be rectified in a matter of months. We don't expect the changing market to work its way to the bottom line until 1986.

Donald R. Frahm
President and Chief Executive Officer
Hartford Insurance Group
Hartford

Underwriting stability is a function of "adequate profitability." For most primary companies heavily dependent on commercial lines, this return to a profitability "threshold" should occur on the completion of the current and the next one or two renewal cycles. Additionally, this is dependent on reinsurers having recovered from their extraordinary losses of the last several years as they continue to provide instability in the marketplace through withdrawal of capacity and accelerated pricing.

Gary L. Countryman
President
Liberty Mutual Insurance Companies
Boston

In the past, the insurance industry's response to financial difficulties has been rapid and surprisingly successful in a short period of time. While one could speculate that a similar response will be seen in 1985, the current underwriting cycle has been very different from previous ones in that (1) the need for price correction has been precipitated by underwriting alone rather than a stock market slump; (2) the need for price correction is predominantly in commercial insurance rather than in personal lines; and (3) reinsurers have suffered particularly severe losses.

The impact of the reinsurance

market on the timing of earnings correction is the hardest factor to assess. Another unknown is the degree to which the industry may be underinsured. Overall, it is likely that a full recovery may take several years, while a substantial reversal of the trend will take less than two years.

Robert F. Bailus Jr.
Senior Vice President
Lumbermens Mutual Casualty Co.
Long Grove, Ill.

The industry did not take real action until the second half of 1984. Stability (acceptable but not profitable results) will not be achieved for 18 months or until early in 1986.

Don D. Hutson
President
Maryland Casualty Co.
Baltimore

Most companies and trade associations are surprised at the depth of rate adjustments that are being exacted in the commercial lines, suggesting that for those insurers that are not too far gone already, a period of stability could be realized in three to five years.

Paul A. Donald
President
Nationwide Insurance Companies
Columbus, Ohio

It took the industry some time to get into the current situation, so the recovery will be slow—perhaps from three to five years before we're fully healed.

George W. Ansbros
Chairman and
Chief Executive Officer
Royal Insurance
New York

If we look at the history of our very large and heterogeneous industry, since the 1950s we have had five underwriting cycles ranging from five to eight years in duration. Two pronounced trends have occurred during this period: these cycles have gotten shorter on the upside and longer on the downside and much more unprofitable. The first three cycles bottomed out at about a 103 combined ratio, the fourth at about 108 and the most recent one at nearly 118, suggesting that results are more volatile than ever before and that underwriting stability in the traditional sense no longer exists.

This can be attributed to many causes, including the destructive com-

mercial lines price competition resulting from the industry's cash flow underwriting techniques that in recent years were facilitated by high interest rates. Because of the inadequate rates that this philosophy helped bring about, and the consequent need for still further price increases in the commercial lines, we expect only a gradual underwriting recovery over perhaps the next three years.

By perhaps late 1988, we would expect a reintensification of competitive pressures followed by a rise once again in combined ratios. While proper underwriting is thus more important than ever, the industry no longer treats underwriting on a stand-alone basis, but rather focuses on the rates of total



WILLIAM O. BAILEY

return that are available in different insurance markets.

James W. Cannon
President
SAFECO Insurance Companies
Seattle

The first step in returning to underwriting stability is to get today's high combined ratio down to a much lower number, at least below 110. That level of combined ratio will still produce an underwriting loss but, at that level, it should also produce a small operating profit which will be the only sound basis for underwriting stability.

In SAFECO's view, true underwriting stability can be achieved only when the combined ratio is under 100 or, in selected commercial coverages, when it is only slightly above 100. Our current efforts are aimed at getting us under 100 just as soon as possible; I

estimate this will be 1986 at the earliest and possibly not until sometime in 1987. My guess is that it will take the industry as a whole longer than that and, in terms of "stability," the real question in my mind is once the industry gets to that point, how long will it stay there? Experience would suggest that it will not be too long.

Robert J. Haugh
Chairman, President and
Chief Executive Officer
St. Paul Companies
St. Paul, Minn.

If by "underwriting stability" you mean the achievement of pricing commensurate with the risk being insured, most companies seem to be well on their way to that target.

However, contrary to the past when cartel pricing permitted a major swing in pricing within a very short time frame, deregulation means that each company is on its own. Each company reaches its own conclusions about pricing objectives, each has its own pace at which it can implement pricing changes throughout its operations and each has its own method and time for knowing how well its pricing changes are being implemented by its field forces. Achievement of underwriting stability will vary from line to line, region to region and company to company.

Of course, getting adequate pricing in place is not the only factor for stability today. Some insurers have not been able to obtain adequate reinsurance to support additional business, or even to maintain what they have, and



PAUL J. SCHEEL

some primary insurers have capacity problems.

Paul J. Scheel
President and Chief Operating Officer
United States Fidelity
and Guaranty Co.
Baltimore

While the companies are underwriting the business for the first time in six years, it will take at least two more years before stability is achieved. At least two more rounds of sizable price increases are needed, and we need to see the level of investment income significantly greater than the level of underwriting losses before any semblance of stability can be restored. The key will be when contributions are being made to surplus from operations.

What lessons did property/casualty insurers learn from their recent flirtation with cash flow underwriting? Has the role of the underwriter undergone permanent change?

Bailey: The role of the underwriter is as important now as it has ever been. From their adventures with cash flow underwriting, insurers may have learned that it is important to understand total return in managing the business.

Trowbridge: The entire industry has been reminded of the importance of

sound underwriting practices. Financial schemes of various shapes came in to vogue during the recent cash flow cycle, and the result was an almost total disregard for pricing adequacy and risk selection. In the long run, underwriting principles cannot be replaced by short-term financial schemes.

The role of the underwriter is

changing dramatically in that the industry environment within which he or she works has changed. An underwriting entity's success will depend on the business acumen of its underwriters in dealing with individual risk and business proposals. No longer will underwriting activity be propped up and protected by a tariff environment.

Morgan: Property/casualty insurers didn't learn much except that you can lose a lot of money really fast. The role of the underwriter hasn't changed, but we sure are reevaluating and, more important, re-educating them.

Nohs: The property/casualty industry as a whole continues to overreact to the competitive pressures of the marketplace, in turn causing periods of solid profitability, severe financial strain such as we are still experiencing and many transition periods. We have found that few companies or agents have been able to remain immune to these pressures. The existence of these cycles forces the quality players involved to emphasize the importance of financial soundness and stability, sound marketing skills, and stable and long-term relationships between companies and agents and agents and customers. Companies and agents continue to look for quality partners and loyal long-term relationships.

As we gradually move from the bottom of this underwriting cycle, the fundamentals of our business again will be stressed by those companies which, like CNA, are in a sound enough financial position to take advantage of the current market. These fundamentals include adequate and proper pricing, a reasonable selection and evaluation of risks and mix of business and the choice of trustworthy business partners. These factors, which are the key ingredients of sound underwriting, will remain important in the future.

Bretherick: Underwriting is always in the process of change, but the fundamentals remain the same. The underwriter's role has evolved over the years as the needs of society have changed—underwriting more complex risks like offshore drilling platforms, for example—and will continue to evolve specifically as the computer is put to use more and more. But the basic role of the underwriter remains unchanged—properly evaluating risk and avoiding the temptations of the marketplace

that divert the underwriter's attention from the bottom line.]

Frahm: The term "cash flow underwriting" has been the broad generality used to sweep under the mat a variety of industry ills and critical errors. It is true that in the late 1970s and early 1980s, we seemed to have an extraordinary amount of capital chasing a limited volume. The period intensified the consumers' awareness of insurance costs and alternative methods of risk



STEVEN H. NEWMAN

transfer, as well as having the financial world scrutinize such factors as return on premium and return on equity in measuring an insurance company's success.

Each of these factors contributed to the underwriters' awareness that the standard benchmark of not exceeding a 100% combined ratio was clearly being challenged. Perhaps the major difficulty in responding to this challenge was the combination of vagueness as to where the new benchmark was, coupled with the lack of inherent ability of the underwriter to "underwrite to a fixed loss."

The basic greed of new-found capital also led to some unusual new underwriting and processing arrangements in the industry, which effectively eliminated any semblance of underwriting while processing premium at very thin rates. The myriad of insurance and reinsurance schemes which fostered this market have at least temporarily collapsed, and this business now is seeking more traditional (and secure) companies.]

A myriad of factors have and will continue to impact the underwriting

process, among them a better understanding of the implications of investment income on the rate-making process. In response to all of these factors, the underwriter must adjust his thinking. However, the basic role of pricing and selection of risks has not changed; it merely needs to be reaffirmed.

Steven H. Newman
President
Home Insurance Co.
New York

Indiscriminate downward pressure on pricing for the purpose of securing market share or positive cash flow directly contributes to an environment in which underwriting discipline is sacrificed. Depressed price levels also cut deeply into funds thought to be available for investment purposes, further aggravating results.

Hopefully, all now understand that insurance is a long-term business in which initial cash flow from risks accepted, and the early incremental investment income it generates, can be overwhelmed in short order as insured liabilities emerge and are settled.

Countryman: Major property/casualty insurers have not "fired" with cash flow underwriting. The competitive insurance marketplace merely adjusted to changing financial markets. The role of the underwriter has not changed, but the insurance industry must learn to better manage the new elements of risk introduced by the volatility of financial markets.

Ballus: It is unlikely that the industry learned anything from its "flirtation with cash flow underwriting." It's more likely that a significant segment of the industry has become entranced with overall financial income and has forsaken a combined ratio of less than 100% as an achievable goal.

Hudson: If insurers learned any lesson, it was the folly of permitting loss ratio levels to chase interest rate levels. Investment income had recognizable limits, while insurer loss levels were considerably greater. It was inevitable that the latter would exceed the former.

Hopefully, underwriters will revert back to much, if not most, of their previous responsibilities, i.e. the selection and pricing of commercial risks on the basis of exposure and expected loss costs. Our company is spending a great deal of resources on training of field

underwriters in basic underwriting techniques.

Donald: The underwriting role has changed, and for many it will require learning the job from scratch. I certainly hope the need to maintain adequate price for the risk assumed will be long remembered. However, the realist in me suggests that if interest rates escalate to the mid and upper teens, and we haven't been sacked by significant tax changes, we could repeat our history again.

Ansbros: It is really too early to be certain whether property/casualty insurers as a group have learned a lasting lesson from their latest foray into cash flow underwriting. However, the main lesson that they should have learned is that carriers cannot reduce their prices below profitable levels for a sustained period of time without creating enormous operating losses. As we have seen, these losses in turn can seriously undermine the financial strength of insurers and therefore their all-important claims-paying ability.

While cash flow underwriting in its broadest sense (writing business at almost any price in order to obtain investable funds) can be a ruinous approach, we do have to recognize that the definition of underwriting profitability generally has been broadened to recognize investment income. This could more appropriately be called "rate of return" underwriting and accordingly the underwriter's role is being redefined to encompass a broader consideration of the financial consequences of underwriting decisions.

As our industry has become much more highly competitive and rates of return have become thin or nonexistent, the fundamentals of careful selection and judicious pricing of risks are more important than ever, and the underwriter must be much more aware of the bottom-line impact of his or her underwriting decisions.

Cannon: I'm not sure that property/casualty insurers in general have learned any lessons from their recent flirtation with cash flow underwriting. They should have learned, again, that it doesn't work. It never has. I don't feel that the role of the underwriter has undergone a permanent change; to the contrary, I would suggest that what we have experienced over the last several years has strongly reaffirmed that the

role of the underwriter should be what it has been defined to be.

Haught: We have learned this still is a business of measuring risks and exposures. The traditional role of the underwriter has not changed; it has been rediscovered. Individual risk selection for the majority of our business, at least the majority of commercial accounts, is more important than ever.

Schoel: While the property/casualty

industry always will be cyclical, I believe that companies will be more cautious next time. The lesson learned is that if you allow your products to be severely underpriced for a long enough period of time and abandon all underwriting principles in the process, the price you have to pay is a hefty one. I believe that if present managements are still around when the cycle turns again, we will see more moderation. If not, who knows? The underwriter remains a key employee in our organization and that will continue. ☐

Many observers have pointed to the likelihood of additional insolvencies in the property/casualty industry before companies return to underwriting profitability. Do you agree? Will state guaranty funds have the capacity to cope with such a situation, given the fact that assessments for the state funds cannot exceed a stated percentage of the capital base of assessed insurers?

Bailey: We do not believe that any well-run insurer is in imminent danger of insolvency.

Trowbridge: We agree with the suggestion that many companies in the property/casualty industry are headed for, if not already in, financial difficulties. It is hard to say how many insolvencies there actually will be since many will no doubt be averted through the merger and acquisition route. To the extent that companies will reach the state of insolvency, there will be a growing strain on state guaranty funds and this, in itself, could contribute to a snowballing problem of companies' solvency problems on a wider scale.

Morgan: There will be more insolvencies, but little ones. The industry will not let a big one go under. State funds can't handle big ones. They were designed for little busts.

Nohar: As in all such periods, there certainly will be a number of property/casualty insurers that will fail. These failures will occur for a variety of reasons. It is difficult, if not impossible, to predict how many and what size they will be, as the dynamics of the

marketplace and management actions will work toward the improvement of many insurers currently in trouble.

The primary challenge in this area is a better system of preventing these failures before they occur. State regu-



PAUL A. DONALD

lators must give this area of their responsibility a high level of priority. Their identification and oversight of

weak companies must improve. If identified early enough, the number of potential failures should be minimized. This should be handled by more timely and appropriate analysis of a more focused set of insurers, by more highly qualified personnel and by more timely action to correct the particular problems being addressed.

Bretherick: The fact that in 1984 investment income in the property/casualty industry did not cover the underwriting loss has sent home a clear message, and that includes the prospect of additional insolvencies. Those insurers that continue to resist taking corrective steps beyond a critical point for their companies will have to adjust their operations in some other way—possibly through capacity withdrawals.

There indeed may be some insolvencies. Should they occur, we believe some state guaranty funds will be unable to respond in full and that will necessitate delaying payment for some claims. Changes in the funds are needed to ensure that their resources are used appropriately. We also believe a properly structured pre-funded guaranty fund would be a better alternative to the current method of assessment.

Frahm: Additional insolvencies will occur. We believe more and more individual state guaranty funds will become inadequate (Florida has already "maxed" out and some claimants could wait as long as three years for sufficient funds to flow to them.) An industry move towards developing a pre-funding mechanism through mandatory surcharges on policyholders is supported by the Hartford. This could provide a more adequate alternative to the current percentage of capital base assessment method.

Countryman: Whether or not the property/casualty industry ever will return to underwriting profitability is open to serious question. However, it is likely to achieve underwriting stability and overall profitability. There is some likelihood of insolvencies before returning to more stable conditions, although this could be prevented by mergers, consolidations or higher interest rates. On the other hand, destabilizing macroeconomic conditions or worsening trends in tort liability cases could push the industry into multiple insolvencies, in which case the guaranty funds probably would not

have the capacity to respond adequately.

Ballus: We expect not only additional insolvencies but also that the internal financial constraints in many companies will impact the industry. We do feel state guaranty funds have the capacity to cope with the expected level of insolvencies.

Hutton: Yes, additional companies will become insolvent, actual or technical.

If identified early enough, the number of potential failures should be minimized."

nical, because (a) many companies show surplus positions only because of deep underreserving in loss reserves, and (b) gimmicks designed to inflate the value of the balance sheet no longer are available.

We do not anticipate any major insolvencies. Rather, we expect to see more changes in the form of mergers and additional growth in the form of acquisitions. Therefore, state guaranty funds should be able to cope with the insolvencies that do occur. Depending on the amount of new money flowing into the industry, the pressure on state guaranty funds may not be as great as some project. In the end, the big losers will be the stockholders of the carriers forced to the wall.

Donald: Yes, there will be insolvencies. I think the state guaranty funds should have sufficient capacity unless a very large carrier becomes insolvent. Much more likely, in my view, are more acquisitions and mergers within the industry.

Ansbros: We believe that the very magnitude of operating losses being experienced by the industry quite possibly could generate additional insolvencies, although the encouraging turn in commercial lines pricing gradually

should alleviate some of the financial pressures on companies writing this business. However, the industry still faces the longer-term possibility of insolvencies from the industry's more persistent problems, including social inflation, asbestos, pollution coverages and a growing number of environmental issues.

While guaranty funds have significant resources to meet policyholder obligations even should demands on these funds increase far beyond historical levels, their capacity really has not been challenged to date. When a major insolvency has materialized in the past, the inadequacies of the guaranty fund mechanism have become apparent. The solution usually has rested in infusions of fresh capital, takeovers by outsiders, or voluntary, insurer-supported rehabilitation efforts at great cost to the industry. In light of this experience and continuing concerns about prospective insolvencies, the industry is seeking to develop alternatives that will expand the guaranty fund system's financial capacity and improve its flexibility to deal with varying situations involving such insolvencies.

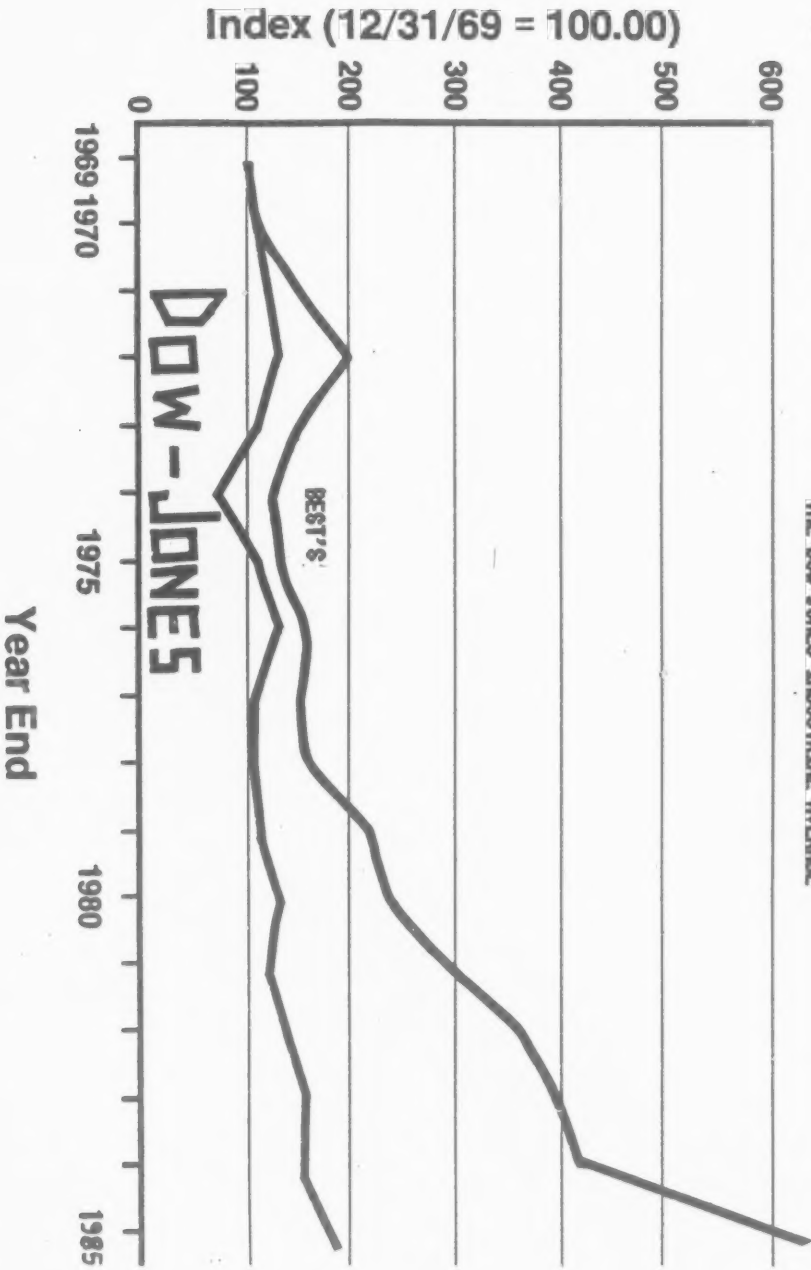
Cannon: It seems possible at this point that there may be additional insolvencies in the industry before most of the companies have returned to underwriting profitability. However, I expect that the state guaranty funds will have the capacity to cope with the situation as it develops and that to the extent that the state guaranty funds do not have the capacity, the private sector will step in as it has on other occasions and do



JAMES W. CANNON

CHART 2

EST'D
 BEST'S PROPERTY/CASUALTY STOCK INDEX
 V.
 THE DOW-JONES INDUSTRIAL AVERAGE



Ex. E

WHAT HAPPENS TO INSURANCE RATES WHEN "TORT REFORM" LEGISLATION IS ENACTED?

Virtually every "tort reform" measure the insurance industry is seeking is currently the law in Ontario, Canada (See Chart 1). Yet the insurance industry is raising premiums by 400%, cancelling coverage in mid-term and refusing to provide coverage at any price in Ontario, Canada just as it is in the United States. For example:

o The insurance industry has refused to provide insurance at any price for Ontario day care centers (See Exhibit 1).

o The insurance industry has refused to provide insurance at any price to all but 1 of 121 Canadian School Boards responding to a questionnaire (See Exhibit 2).

o The insurance industry has refused to provide liability insurance for Toronto and many other cities (See Exhibit 3).

o The insurance industry has refused to provide liability insurance at any price to the Canadian national ski teams, which have never had a major claim against them (See Exhibit 4).

o The insurance industry has raised premiums 1000% and at the same time reduced coverage for the Ontario intercity bus industry (See Exhibit 5).

o Hospitals in Toronto can still get insurance, but only at "greatly increased" premiums (See Exhibit 6).

o An insurance company renewed the Ontario School Bus Operators Association's policy on December 1 — at 400% more than it charged the year before (See Exhibit 1).

If any of the organizations denied coverage were ever sued — and many of them have never been sued in the past — they would be sued under the laws of Ontario, where pain and suffering awards are capped at \$185,000, punitive damages are virtually non-existent, contingency fees are prohibited and the plaintiff must pay the defendant's attorney's fees if he loses. Yet the insurance industry is raising its rates 400% and more, cancelling policies in mid-term and refusing to provide coverage at any price both in the U.S., which has not enacted the tort provisions the industry seeks, and in Ontario, Canada, where such provisions have long been in the law.

E. F.

HOW TO MAKE THE LEGAL SYSTEM MORE EFFICIENT

1. Limit defense lawyers' fees. Since 1956, defense lawyers' fees have risen almost three times as fast as the amount insurance companies pay to injured people, according to the National Association of Independent Insurers. Of the money spent by a corporation in a typical liability case, more money goes to the defense lawyer than to either the plaintiff's lawyer or the plaintiff himself.
2. Establish automatic, severe sanctions for frivolous motions, objections, and defenses. Because defense lawyers charge by the hour, they have an incentive to delay. To "keep their meters running," they may raise defenses, file motions, interpose objections and brief and rebrief the same issue — no matter how untenable their position — even if settling the case quickly would save their clients money. As long as there is no effective sanction for such tactics, defense lawyers will continue to delay — to the detriment of the legal system and often of their own clients.
3. Limit plaintiff's lawyers' contingency fees to one-third. Plaintiff's lawyers have no incentive to delay, since they get paid only if and when they win. And the contingency fee system is invaluable in allowing average people who could never afford to pay a lawyer by the hour their day in court. But if a lawyer will take a case only on a 40% or 50% basis then the case is too speculative and probably should not be brought. The traditional one-third contingency fee has worked well for both attorney and client and should not be exceeded.
4. Prohibit secrecy agreements. Defendants will often settle a case only if the plaintiff agrees never to disclose evidence in the case to any other plaintiff. Such agreements create more unnecessary work for defense lawyers and force plaintiff's lawyers to continually re-invent the wheel.
5. Expand the use of offensive collateral estoppel. Even when courts have already held a product to be defective, each plaintiff injured by that same product must re-prove that the product is defective. Again, this creates unnecessary delay and unnecessary work. It would be much more efficient to allow prior holdings that a product is defective or that a product has caused an injury to be used in other cases.
6. Transfer relatively small cases where the deterrent function of the tort system is less important into alternative, "no-fault" type systems. For example, in auto accident cases, where criminal penalties and the instinct toward self-preservation presumably deter negligent conduct, a well-structured no-fault system may compensate people more efficiently than the tort system without substantially lessening deterrence.
7. Increase the use of voluntary arbitration and mini-trials as alternatives to the tort system.
8. Transfer all inter-defendant disputes — e.g., between a manufacturer and its insurance companies — into an alternative dispute resolution system.
9. Establish nationwide and world wide service by mail to the greatest extent possible. With many corporations doing business through subsidiaries in all 50 states and throughout the world, service on a subsidiary should be service on the parent. Today, particularly when Japanese holding companies are defendants, it may take months just to perfect service.
10. As a prerequisite to any changes in the legal system, the insurance industry must agree that it will lower its rates by a specific amount if specific changes are enacted. Otherwise, such changes are futile.

Senator McCONNELL. I have several but I would like to take about a 2-minute recess to make a phone call. I will be right back.
[Short recess.]

Senator McCONNELL. The committee will resume.

What is the actual effect of the antitrust exemption and do the companies in your opinion actually collude in ratemaking or do they share data or what do they do?

Mr. ANGOFF. They share data and they fix a uniform price, a recommended price. That does not mean that it has to be followed by the rest of the industry. We do not know exactly what the insurance industry does. We do know though that it is not legal for them under the *Berry* case of 1979, it is not legal for insurance companies to just boycott, not to insure at all, but it is legal for them to, say raise prices by 500 percent in concert. I do not know whether that happens, but I think that this committee should find out because it could happen and, as Adam Smith says—I cannot give you an exact quote, but as Adam Smith says, whenever people get together there certainly is the possibility that they will price fix.

Senator McCONNELL. The problem of premium increases seems to be different from the problem of insurance unavailability. How do you explain the problem addressed by Ms. Locke right before you in which whole industries are unable to get insurance?

Mr. ANGOFF. I do not. There seems to be no rational basis, for example, and the day care area is the best example. I am told that there were 5 million dollars' worth of claims paid last year in the entire country against day care centers, and that is tiny and the statistics show that as far as day care insurance is concerned, that companies take in much, much more than they actually pay out, so I cannot rationally explain it.

I have seen it suggested in the trade press that it is a panic mentality, that one company withdraws from the industry and then everybody else panics and withdraws, too, but there is no legal doctrine justifying that.

Senator McCONNELL. Is it just a question of predictability? If the actuaries are unable to predict with any competence the nature of their liability and the extent of their exposure, how can they afford to write coverage, so the argument goes?

Mr. ANGOFF. Well, it is not perfectly predictable, and very few things are, but there seems to be no factor that seems to set apart day care centers from other insurers that would make day care centers uninsurable. I should mention that I think, and maybe subsequent witnesses will tell you more about this, but I think Continental or one of the insurance companies has come out with a program to insure day care centers, although there are quite a few exclusions. But I cannot rationally explain it. I think that is a question that the insurance industry would be better able to answer than I can.

Senator McCONNELL. Well, leaving aside day care for just a minute, on the question of unpredictability, is not a large part of the problem of unpredictability related to the constant expansion of causes of action or basis for liability or limitation of defenses?

Mr. ANGOFF. That is the data we have got to find out, and I do not purport to have all the data, but it may be that the data will

show that courts have dramatically expanded liability doctrines, that there are new causes of action, but to my knowledge there are not and to my knowledge there has been very little money actually paid out. I mean that is the data that we have got to get.

Senator McCONNELL. How much should an insurer charge for coverage of a new Federal cause of action such as the Superfund law created or, for example, how much should a hospital be charged for insurance today if next year the Federal Government creates a new right of action for refusal to treat indigent patients?

Mr. ANGOFF. It is more difficult—to answer your question, I do not know. It is more difficult, no question, to insure insureds who are subject to new causes of action to new liability. That does not mean it cannot be done, but it is more difficult. But unfortunately what we are seeing now—and we get calls on this every day—is business people who have not had a claim against them for 37 years, who pay their premiums on time and for whom expanded liability just is not a factor and they cannot get insurance.

I wish I could answer the question. I just think we have got to find out exactly how insurers make their rates and maybe we will find that there is a problem in certain lines, but we have got to get the data from the industry first.

Senator McCONNELL. I agree with that, but I am still going to pose some of these questions to you. I think there are a lot of questions that need to be answered by the industry.

How should a company charge generally when damage awards increase year by year with almost no relation to the economic realities of the injury?

Mr. ANGOFF. Well, if that is true then those are the lines where there is a problem. If damage awards do increase dramatically year by year, obviously the company should charge more and I suppose it could get to such—the increases, the trend could be just so dramatic that there would be, that a refusal to deal would be justified and that maybe certain reforms of the legal system should be imposed. I just have not seen the data like that.

Senator McCONNELL. Well, your testimony certainly suggests a number of different lines of inquiry that we are going to go into on March 25 and 26, and I would also like to submit some additional questions to you in writing, if I could.

Mr. ANGOFF. That is fine, Mr. Chairman, and I would be glad to answer them.

Senator McCONNELL. I would like to thank you very much for coming.

Mr. ANGOFF. Thank you, Mr. Chairman.

Senator McCONNELL. Our next and final witnesses are a panel of three: Mavis Walters, who is vice president of the Insurance Services Office—we will take Mr. Schwartz by himself and we will take Ms. Walters and Mr. Kimble, counsel to the American Insurance Association.

STATEMENT OF MAVIS A. WALTERS, SENIOR VICE PRESIDENT,
INSURANCE SERVICES OFFICE, INC.; AND JAMES KIMBLE,
SENIOR COUNSEL, AMERICAN INSURANCE ASSOCIATION

Ms. WALTERS. Thank you, Mr. Chairman. I am surely tempted to spend all my time responding to the things we heard beforehand, but perhaps it would be better used to summarize very briefly first my formal statement and then perhaps later we will have some questions.

I am Mavis A. Walters, senior vice president of Insurance Services Office, Inc. and a fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries.

Insurance Services Office, Inc. is a nonprofit corporation that makes available rating, statistical, actuarial, policy form and related services to any U.S. property-casualty insurer. We are not a trade association and we do not lobby, but we are merely a technical service organization that provide information to insurance companies to assist them.

During the past year, the availability of property-casualty insurance has come to the forefront as a major public issue. Insurers have found the need to dramatically raise prices and in some instances to recognize that certain classes of business may simply be uninsurable today.

During these difficult times, rather substantial differences have emerged between the property-casualty insurance business and some critics over the true financial condition of the industry. In order to separate fact from fiction and permit an objective determination of the current financial state of the industry, Insurance Services Office is now completing a document which presents a broad and thorough perspective of the property-casualty industry's financial condition. It also refutes the critics charges point by point. Printed copies should be available by the end of next week and a copy will be submitted for the record of this hearing.

Senator McCONNELL. We would be very interested in seeing it.

Ms. WALTERS. I would now like to summarize just a few points from that report and from my formal testimony.

It is beyond dispute that 1984 was the worst year to date for the property-casualty insurance industry. The industrywide return on net worth was below 2 percent in 1984, with total earnings for the entire industry of only \$1.3 billion. To put that in perspective, the Fortune 500 companies' median return was 13.6 percent in 1984. In fact, some people think that insurance companies are just money machines, but in 1984 many insurers actually lost money overall.

Three hundred thirty insurer groups representing 40 percent of the total industrywide premiums recorded negative returns on net worth in 1984. The most important component of insurers' net income after taxes is operating income, and that is simply the sum of underwriting income that is the difference between premiums earned and claims expenses and policyholder dividends and investment income. Operating income represents the sum of underwriting income and investment income. Underwriting income has actually been a loss beginning in 1979, each subsequent year brought an evergrowing underwriting loss which reached a staggering \$21.7 billion in 1984.

In all but 2 years of its history, the industry's investment income, that is, the interest and dividends received on investments, was sufficient to offset those underwriting losses. The first time investment income did not exceed underwriting losses was in 1975, and in that year investment income fell short of the underwriting deficit by today we would say a mere \$300 million.

In 1984, a new record was set, with underwriting losses exceeding investment income by \$4.1 billion. Only unusually high capital gains and some tax credits allowed the industry's bottomline earnings to be positive in 1984, but these sources of income are not predictable and they are not regularly recurring and therefore they cannot be depended upon to provide similar amounts of additional income in future years.

If the industry is to maintain a reasonable level of profitability for the long term, profits must come from operating income, but that positive operating income, the difference again between underwriting loss and investment income, has been very, very hard to achieve. In fact, all available evidence now indicates that we will see a record operating loss for 1985, despite the substantial premium increases in that year, and it is highly unlikely that the final year 1985 return on net worth will exceed 4 percent.

Again, remember we are talking about, for comparison purposes, a return for the Fortune 500 in excess of 13 percent.

Insurers that concentrate in commercial lines—and that in the area where most of the availability, in fact I would say virtually all of the availability of affordability problems are being felt in the commercial lines area, and for those insurers the returns have been even worse.

Those who concentrate in commercial lines have experienced a negative 3-percent return on net worth in 1984. Reinsurers, who have grown to be an important segment of the industry and who have provided a crucial link in the availability of insurance coverage have also had disastrous results recently. They experienced a negative 10-percent return on net worth in 1984. This result was a significant factor in the insurance marketplace disruptions that occurred in 1984 and 1985.

Some critics have alleged that the recent years have reflected nothing more than a typical cyclical period for property-casualty insurance. The fact is that this has been anything but a typical cycle. Underwriting losses, operating losses, combined ratios, the number of insolvencies, and the number of companies targeted for regulatory attention were all at record highs in 1984, while the industrywide return on new worth, as I stated, was at an all-time low. And reinsurers, on whom the insurers depend as never before, have been very seriously weakened. All of these elements are strong evidence that this is not just a typical cycle for the property-casualty industry.

Critics have also charged that premium increases currently are just too high and there is no extraordinary or unusual growth in losses that can possibly justify these increases. That charge is also incorrect.

Certainly, no one is going to deny that insurers did reduce prices far below the level needed to cover loss costs, but the growth in property-casualty losses has far exceeded the country's economic

growth in the past 5 years. Each year, losses have surpassed expectations and losses are now growing faster than any standard measure of economic growth.

During 1979 to 1984, paid losses overall grew 76 percent or 3.4 points per year faster than GNP. And commercial liability paid losses increased 130 percent during the period, well over double the GNP rate.

While current availability and affordability problems are certainly due in part to past price reductions, a major contributor to the problem today has been the significant increase in losses far beyond normal economic growth.

The large premium increases occurring now, particularly for the commercial liability line, will not recoup past losses or makeup for recent substandard returns. These increases are needed simply to bring insurance prices up to the level of loss costs which are expected to be incurred under today's insurance policies. A full discussion of these points and others, as well as explanatory charts, graphs, and exhibits, will be included in the ISO document now being completed. As I said, I will submit a copy for the record and, of course, I will be pleased to answer any questions you may have.

Thank you.

[The prepared statement of Ms. Walters follows:]

STATEMENT OF
MAVIS A. WALTERS
SENIOR VICE PRESIDENT
INSURANCE SERVICES OFFICE, INC.

I am Mavis A. Walters, Senior Vice President of Insurance Services Office, Inc. I am a Fellow of the Casualty Actuarial Society (CAS) and a member of the American Academy of Actuaries, and currently serve as an elected member of the Board of Directors of the CAS.

Insurance Services Office, Inc. (ISO) is a non-profit corporation that makes available rating, statistical, actuarial, policy form and related services to any U.S. property/casualty insurer. ISO provides advisory research services to more than 1300 property/casualty insurance companies in the U.S. ISO is not a trade association and therefore does not engage in lobbying on behalf of insurers.

ISO has no mandatory membership requirements, nor do we have adherence requirements with respect to advisory rates, loss costs, policy forms or programs. In fact, we actively encourage independent action by participating insurance companies. ISO is committed to providing the information tools that will help its participating insurers serve the insurance-buying public.

We serve participating insurers by gathering, storing, and disseminating statistical information to regulators, as required by law, and to insurers for their own use. We also develop and assist in implementing programs that help define and cover risk. We promulgate advisory rates or advisory prospective loss costs for sixteen lines of insurance including personal lines (automobile and homeowners) and commercial lines of insurance such as Commercial General Liability (CGL).

During the past year, the availability of property/casualty insurance has come to the forefront as a major public issue. Insurers have found the need to dramatically raise prices and in some instances recognize that certain classes of business may simply be uninsurable. During these difficult times rather substantial differences have emerged between the property/casualty insurance business and some critics over the true financial condition of the industry. In order to separate fact from fiction and permit an objective determination of the current financial state of the industry, Insurance Services Office is now completing a document which presents a broad and thorough perspective of the property/casualty industry's financial condition; it also refutes the critics charges point by point. Printed copies should be

available by the end of next week and a copy will be submitted for the record of this hearing.

This testimony presents a summary of the more important sections of that report.

It is beyond dispute that 1984 was the worst year to date for the property/casualty insurance industry. The industrywide return on net worth was below 2% with total earnings of only \$1.3 billion. The Fortune 500 companies' median return was 13.6% in 1984, averaging 13.2% over the last 10 years, and has never fallen below 10% during that time. During the 1980's the return on net worth for the property/casualty industry has moved increasingly below the average rate for the Fortune 500.

Many insurers actually lost money overall. Three hundred thirty insurer groups representing 40% of total industry premiums recorded negative returns on net worth in 1984. Eighty-four insurers lost more than one-quarter of their surplus during that year.

The most important component of insurers' net income after taxes is operating income - the sum of underwriting income and investment income. Underwriting income (the difference between premiums earned and the sum of claims, expenses, and policyholder dividends) has actually been an underwriting loss beginning in 1979. Each subsequent year brought ever-growing underwriting losses -- reaching a staggering \$21.7 billion in 1984.

In all but two years of its history, the industry's investment income (the interest and dividends received on investments) was enough to offset underwriting losses. The first time investment income did not exceed underwriting losses was in 1975, when investment income fell short of the underwriting deficit by \$300 million. In 1984, a new record was set, with underwriting losses exceeding investment income by \$4.1 billion. Only unusually large capital gains and tax credits allowed the industry's bottom-line earnings to be positive in 1984. However, these sources of income are not predictable or regularly recurring and therefore cannot be depended on to provide similar amounts of additional income in future years.

Until very recently, capital gains realized by the property/casualty industry were relatively insignificant compared to net worth. From 1975 to 1982, total realized capital gains never exceeded 1% of net worth, but in 1983, the ratio grew to 3% and continued upward in 1984 to 4%. In addition, during the last 2 years substantial tax credits were available to property/casualty insurers that incurred

a pre-tax loss for the year, if they paid taxes during a prior taxable period. Substantial tax credits cannot be expected to continue.

In 1984 the property/casualty insurance industry benefited from nearly \$5 billion of realized capital gains and tax credits. However, over the prior twenty years the average of total capital gains and federal income taxes was a net of only \$500 million a year. Given their historically small contribution to total profit, realized capital gains and taxes cannot be relied upon to provide a continuing and consistent bailout for operating losses. If the industry is to maintain a reasonable level of profitability for the long term, profits must come from operating income.

Positive operating income - the difference between underwriting loss (after policyholder dividends) and investment income - has been hard to achieve. Although investment income has grown steadily over the last decade to \$18 billion in 1984, its average annual increase since 1980 has been less than \$2 billion, while underwriting losses increased at an average annual rate of over \$4 billion. All available evidence indicates a record operating loss for 1985, despite substantial premium increases. If operating income is to become a source of profits, underwriting losses must be drastically reduced from the 1984 level of almost \$22 billion. For this to happen, premium increases would have to continue to exceed the rate of growth in claim costs.

Actual year-end 1985 results for the property/casualty industry will not be compiled until late March or early April. However, figures for the first nine months of 1985 show only slight improvement over the comparable period in 1984. It is highly unlikely that the full year 1985 return on net worth will exceed 4%.

The underwriting loss of 1985 is expected to exceed the 1984 record of \$21.7 billion. During the first 9 months of 1985 the industry recorded an underwriting loss of \$17.8 billion, compared with a loss of \$15.2 billion for the first 9 months of 1985.

During the first 9 months of 1985, investment income fell short of the underwriting loss by \$3.4 billion, compared with the shortfall of \$2.5 billion for the first 9 months of 1984. All available evidence indicates a record operating loss for 1985.

Financial results have varied widely among insurers. For example, since 1979, insurers that concentrated in the personal lines fared better than the remainder of the industry. While these personal lines insurers' profits dropped from 1979 to

1984, their decline has been more moderate than that of the entire industry. The return on net worth for predominantly personal lines insurers fell from over 13% in 1979 to below 8% in 1984.

Insurers that concentrate in commercial lines have experienced a much more dramatic drop in earnings. In 1979, this group achieved a slightly higher return than personal lines insurers, posting a 15% return on net worth. The return declined steadily during the early 1980's, reaching a negative 3% return on net worth in 1984.

Reinsurers, who have grown to be an important segment of the industry, and who have provided a crucial link in the availability of insurance coverage have had disastrous results recently. Their recent returns have been considerably worse than the industry average.

From 1979 through 1983, U.S. reinsurers' returns on net worth were comparable to those of the entire industry. In 1984, reinsurers' returns plummeted to a negative 10%, nearly twelve points below the industry average. This result was a significant factor in the insurance marketplace disruptions that occurred in 1985. Many reinsurers withdrew partially or totally from writing business; others restructured coverages (adding exclusions or restrictions) and increased prices in an attempt to return to profitability.

A TYPICAL CYCLE?

Some critics have alleged that the recent years have reflected nothing more than a typical cyclical period for property/casualty insurers. The fact is that this has been anything but a "typical" cycle. Underwriting losses, operating losses, combined ratios, the number of insolvencies, and the number of companies targeted for immediate regulatory attention were all at record highs in 1984, while the industrywide return on net worth was at an all time low. And reinsurers, on whom the insurers depend as never before, have been seriously weakened.

The 1984 underwriting loss was \$21.7 billion. Prior to this cycle, the record underwriting loss was \$4.2 billion in 1975. The 1984 operating loss was \$4.1

billion. The previous record was \$0.3 billion in 1975. On the basis of bottom line results, the 1984 return on net worth was 1.7%, despite a record \$4.8 billion of realized capital gains and tax credits. The previous low return on net worth of 2.4% occurred in 1975 when the sum of tax credits and realized capital gains was only \$0.7 billion. Even the extraordinary amount of realized capital gains and tax credits in 1984 did not compensate sufficiently for the huge operating losses to produce a return on net worth equal to the 1975 level. The 1984 combined ratio was 118.0. Prior to this cycle, the record was 107.9, again, in 1975.

In 1969, the National Committee on Insurance Guaranty Funds began to collect data on insolvencies that trigger state guaranty funds. Until last year, the record number of insolvencies in any two year period was 25. During 1984-85 there were 40 insolvencies and the books are not yet closed.

The National Association of Insurance Commissioners (NAIC) developed an early warning system to alert regulators to potential insolvencies. In discussing the 1985 test results, Iowa Insurance Commissioner Bruce W. Foudree, former President of the NAIC, said the 215 property/casualty insurers have been targeted as in need of immediate regulatory attention under the NAIC early warning system, "the most ever and a 73% increase over last year".

One of the most important differences between this down cycle and all previous ones is its length. This time, the combined ratio worsened for seven consecutive years beginning in 1978. Previously, the longest continuous period of deteriorating combined ratios was for the five years 1960 through 1964. During that period, however, the combined ratio worsened by only five points; in this cycle it deteriorated by 21 points.

Another indicator of the depth of this cycle is the number of insurers receiving a reduction in any year from the A.M. Best rating of A+. That number increased from 23 in 1982, to 61 in 1983, to 80 in 1984 and finally to 149 in 1985. In 1985 only 24% of the companies rated received an A+ compared with an average of 39% in 1976 and 1977 following the last adverse underwriting cycle.

The property/casualty industry is now more dependent on the reinsurance mechanism than ever before. During 1979-1984, reinsurance recoverable (monies owed to insurers by their reinsurers) more than doubled, while premiums and surplus grew by 30% and 50%, respectively. For reinsurers themselves, the amount more than tripled during this period while their premium and surplus grew by 54% and 73%, respectively. At the same time as dependence on reinsurance rapidly increased, reinsurers' financial condition seriously eroded. The 1984 return on

net worth for the entire insurance industry was nearly 2%, while it was -10% for reinsurers. In 1985, A.M. Best lowered the ratings of half the reinsurers rated.

For the past two decades, reinsurers' combined ratios have closely paralleled those of the property/casualty industry with the gap never exceeding $4\frac{1}{2}$ points, except for the 6-point gap in 1965, the year of Hurricane Betsy. As recently as 1982, the two combined ratios were only 1/10 of a point apart. The gap grew to 6 points in 1983 and then to 13 points in 1984. Although this gap began to narrow in 1985, reinsurer combined ratios are still substantially worse than those for the entire property/casualty industry.

Historically, personal and commercial lines results have been similar. Between 1967 and 1982, the difference between the combined ratios never exceeded 6 points. As recently as 1981, the ratios were only 2 points apart. Then in 1983, the gap grew to 12.5 points. In 1984, when it grew to over 20 points, those insurers writing predominantly commercial lines had a negative return on net worth. In 1985, the gap began narrowing but still stood at nearly 15 points for the year ended September, 1985.

An even greater concern for commercial lines insurers and reinsurers is that their combined ratios are understated due to reserve inadequacy. Because of this, the combined ratios for these insurers are undoubtedly even worse than the record highs recorded.

Richard E. Stewart, former Superintendent of Insurance of the State of New York, discusses the current cycle in a December, 1985 Marsh & McLennan Commentary article. In it, he writes: "...this is not just a routine turn in the underwriting cycle. It has structural as well as cyclical causes." He further notes, "Whereas economic inflation drove the casualty insurance crisis of the mid-seventies, the current one is driven by terrible events and by changes in liability law". And he adds: "Insurance has met liability problems before. These are liability disasters. No exclusion is reliable, no excess level out of reach."

All these elements strongly support the conclusion that this is not just a "typical cycle" for the property/casualty insurance industry. Because reinsurers and commercial lines insurers have been hit harder, premium increases will fall unevenly, with some policyholders experiencing very large increases. Because the industry's downturn lasted longer than ever before, the recovery must last longer as well. And, because the depth of the downturn was worse than ever before, a stronger recovery will be necessary.

A MANUFACTURED CRISIS?

Critics have charged that premium increases currently are too high and they result solely from insurers' past inadequate prices. There is no extraordinary or unusual growth in losses to justify these increases so they claim.

Their charge is incorrect. Certainly, no one can deny that insurers reduced prices far below the level needed to cover loss costs. However, growth in property/casualty losses has far exceeded the country's economic growth in the past 5 years, as measured by GNP. Each year, losses have surpassed expectations and losses are now growing faster than any standard measure of economic growth.

During 1979-1984, GNP grew 50% while written premium increased only 34%, or 2.4 points per year slower than the average annual GNP growth rate. On the other hand, paid losses overall grew 76%, or 3.4 points per year faster than GNP. Moreover, the increase in losses was not uniform across all lines of insurance. Commercial lines paid losses grew 92% while personal lines paid losses increased 62%, and commercial liability paid losses increased 130% during the period -- well over double the GNP growth rate.

Finally, general liability and medical professional liability paid losses have grown 167% over the 5 year period -- more than triple GNP growth. From 1979 to 1984, paid loss growth averaged 22% a year -- 13 points more than the average GNP growth rate.

While current availability and affordability problems are certainly due in part to past price reductions a major contributor to the problems has been the significant increase in losses. From 1979 to 1984 policyholders had the benefit of low insurance price levels that did not keep pace with losses. But, as a result, the insurance industry endured below average returns on net worth every year since 1979.

The large premium increases occurring now, particularly for the commercial liability lines, will not recoup past losses or make up for recent substandard returns. Such increases are needed simply to bring insurance prices up to the level of loss costs expected to be incurred under insurance policies written today.

LOSS PAYMENTS OVERSTATED?

Critics have charged that insurance industry financial figures are misleading and distorted since their incurred losses contain estimates of future loss payments which are often overstated. The industry manufactured the last medical malpractice "crisis" by overreserving and has done the same thing this time, so the critics allege.

Not only does this charge have no basis in fact but it also contradicts the consensus opinion of recognized financial analysts, who believe that current loss reserves are understated. A published ISO study concluded that year-end 1982 industrywide loss reserves were deficient by more than 10%. Subsequent ISO analyses indicate that no significant strengthening occurred in industry loss reserves through year-end 1984. Furthermore, time has shown that, at the time of the last crisis in 1976, industry loss reserves were seriously understated.

It is true that loss reserves are estimates, made by insurers on a given date, of what additional loss payments will ultimately be made for a particular set of claims. State insurance commissioners, charged with overseeing the solvency of insurers, suggest that loss reserves for most lines of insurance be reported at their full ultimate value. Reserves are particularly significant for the liability lines, for which the final payout may not be known for many years, which is why they are known as "long-tail" lines.

At the time of the last crisis -- 1976 -- the reserves set aside at year-end 1976, for all claims incurred to that date were \$47.1 billion. As of year-end 1984, \$48.6 billion had been paid out on those initial pre-1977 claim reserves. And an additional \$8.0 billion was still held in reserve for the same group of claims -- for a total payment of \$56.6 billion rather than the \$47.1 billion originally expected. The nearly \$10 billion difference represents an initial reserve deficiency of 20%.

One reason that reserves set in the past for long-tail lines such as general liability have proven to be deficient is that scientific, technological, and societal changes have revealed new sources of exposure to injury and new theories of legal liability. For example, when general liability losses were reserved 10 to 20 or more years ago, insurers could not have predicted the huge number of claims related to asbestos, Agent Orange, DES, and other alleged causes of latent injuries under policies already written. At that time, no reserves were set up for future payments of those losses. It is now clear that the initial reserves established for those general liability policies will prove to be significantly understated.

This pattern of underreserving can easily be seen in two particularly long-tailed lines, general liability and medical malpractice. In 1976, general liability claim payments already made, plus the reserves carried for future payments on policies written through that year, totalled \$24.0 billion. At year-end 1984,

the estimated costs for those same general liability claims had risen to \$28.0 billion, of which \$26.0 billion had already been paid. This means that, as of year-end 1984, the original 1976 reserve was already insufficient by \$4 billion.

For medical malpractice, the estimate for ultimate claim payments on the policies written through 1976 initially totalled \$1.9 billion. The year-end 1984 estimate for those same medical malpractice losses had risen to \$2.3 billion, of which \$1.9 billion had already been paid. This means that, as of year-end 1984, the original 1976 reserve was already insufficient by \$400 million.

The 1976 loss reserves were not unique. More recent years show a similar pattern of final losses which are likely to exceed the initial reserves. For example, the 1979 reserve for liability lines was \$65.3 billion at year-end 1979. As of year-end 1984, \$53.8 billion of those reserves had been paid and \$15.7 billion was still held in reserve, for a total of \$69.5 billion -- an initial reserve deficiency of more than \$4 billion (6%) as of year-end 1984. Given recent historical trends, it is likely that estimated final claim payments -- and therefore, the reserve deficiencies -- will grow as later evaluations are made.

A fuller discussion of these points and others, as well as explanatory charts, graphs and exhibits will be included in the ISO document now being completed. The printed document will be submitted for the record as soon as it becomes available.

Senator McCONNELL. Thank you. Senator Specter has joined us. Senator Specter, do you have an opening statement?

OPENING STATEMENT OF SENATOR ARLEN SPECTER

Senator SPECTER. Yes; thank you very much, Mr. Chairman. First, let me commend you for convening these very important hearings on alternative dispute resolution. Certainly with the problems of the backlog of courts, this is a subject of enormous importance. It is a subject that I have been interested in for a long time. I have seen the processes of arbitration of the Philadelphia Bar Association at the local level worked out and at the time when I was district attorney I worked for methods of clearing up the calendars with a program known as preindictment probation, going back to the early 1970's, later known as accelerated rehabilitative disposition.

Cases were called in for prompt disposition of first offenders with nonviolent records, a full panorama of ways to relieve court congestion is a matter of enormous importance, so I again commend you for convening this hearing, Mr. Chairman.

I would like to submit questions for the record, if I may. I regret that I cannot stay longer, but I will be reviewing the transcript of the proceedings and I join Senator McConnell in thanking you for your participation.

Senator McCONNELL. Thank you very much, Senator Specter.

Now I would like to call on James Kimble, general counsel of the American Insurance Association. Mr. Kimble.

STATEMENT OF JAMES KIMBLE

Mr. KIMBLE. I appreciate the promotion. I am a senior counsel with the American Insurance Association. I would like to spend a few minutes on the role of the tort system in the business of Insurance, how and why we must interact with the tort system.

We service the tort system. We pay claims which are generated through and by the tort system, therefore we must make judgments as to the development of the tort system.

The legal system in the United States is not constant, it is not static. Our task as underwriters and ratemakers is not solely to look at the past. We cannot rely simply on our past experience on claims which have been paid and the tort system as it exists today.

We must make judgments as to the future of the tort system and the development of the tort system, both in the common and statutory law. These developments sometimes are discernible trends. However, unfortunately, often the tort system takes great leaps in imagination.

If insurance prices are to be stable, there is a need for stability in the development of the tort system. These great leaps in imagination cannot be predicted by the insurance industry.

In the last two decades there has been a major transition in the types of claims which we paid. Traditionally, we have responded to what we called an accident, something which is discernible in time, something in which the casual link is readily identified, a finger in a punch press or a fenderbender car accident.

In the last two decades, we have moved away from what we called an accident to what we are now currently calling an occurrence. An occurrence frequently is a nontraumatic, multiple causation, long-latency disease. All of the criteria which go into actuarial science and ratemaking are skewed when one talks about long latency and multiple causes.

In a multiple causation situation, individual behavior on the part of the defendant is frequently irrelevant. In a long-latency situation, we must predict today what the tort system will be like 20 or 30 years from now when the cancer manifests itself, because we may have to pay for that cancer through an insurance policy which we issued years ago.

I remain a student of tort law. Your next witness is a true scholar. Nevertheless, I would like to mention a few cases which I would categorize as in the category of great leaps in imagination.

First, the *Sindell* case. That is the first market share case. In that situation, the plaintiff did not have to pinpoint or locate the manufacturer of the pharmaceutical. Individual behavior was rendered meaningless in that situation.

The *Beshada* case, that is an asbestos case, and in that case the defense of state of the art was ignored and the defendant was placed in the situation in the 1930's of having to anticipate the state of the art in the 1980's. In other words, the product which was manufactured in the thirties had to meet scientific standards in the eighties. Again, individual behavior rendered meaningless. The key to underwriting his individual behavior.

The third case is not an advance in tort law, it is an example of a judicial misinterpretation of an insurance contract, and that is the *Jackson Township* case. There are about 10 or so additional cases similar to the *Jackson Township* case. The fact situation in that instance was a pollution situation in which a landfill owned by a municipality spoiled 97 wells.

That township had a commercial general liability policy which was designed to respond to a sudden and accidental event offsite and respond to damages for bodily injury and property damage. In *Jackson Township* and in several other cases, if you put them together in a collage, what you get is the comprehensive general liability policy responding to a nonsudden event, onsite, for cleanup, so the defenses and the exclusions in that CGL policy were ignored in the courtroom, again something which simply cannot be anticipated by the insurer.

Finally, I would like to give a couple of examples at the Federal level of what the insurer has to cope with in terms of predictability. You mentioned the Federal cause of action in Superfund earlier. In the House of Representatives, there were three attempts in the current Superfund reauthorization process to include a Federal cause of action for bodily injury in that bill. There is language or was language in that amendment which was defeated which suggested that there could be no award for pain and suffering for "unreasonable fear." That suggests to me that perhaps the insurance industry would have had to respond for pain and suffering for reasonable fear. What is reasonable fear?

Finally, currently in the House Superfund bill there is a modification to the statute of limitations which applies to toxic torts. In

some States, there is an exposure based statute which runs from the date of exposure. That arguably is an unreasonable burden to meet in a long latency situation because the statute of limitations can run before the disease manifests itself.

The statutory language would modify the statute of limitations in those States with an exposure base in order to move to a discovery based statute of limitations. That perhaps is reasonable. However, that language would be applied retroactively and therefore it would be applied retroactively to old insurance policies. How can we anticipate that kind of statutory language?

In conclusion, the American Insurance Association applauds your efforts. We are very interested in your bills and we are pleased that they were introduced. We have not had an opportunity to formalize our position on those bills, certainly the concepts embodied in those bills are very useful and would have an impact on the tort system and therefor on insurance premiums.

Thank you.

[The prepared statement of Mr. Kimble follows:]

PREPARED STATEMENT OF JAMES KIMBLE

The American Insurance Association (AIA) is a trade association which represents 170 property and casualty insurance companies. The member companies of the Association provide the majority of the commercial liability insurance coverage written throughout the United States. We have been asked to present testimony associated with the tort liability system and its impact on the property/casualty insurance industry.

Insurers are exhibiting neither panic nor irresponsibility by taking a conservative stance on writing certain lines of commercial liability coverage. Rather, they are being prudent in the face of unprecedented losses and a rapidly changing operating environment.

UNDERLYING CAUSES

The "insurance industry" is not monolithic. Even the largest companies have a small portion of the total market share in any single line of insurance. Individual insurers engaged in intense competition in the early 1980's in pursuit of the premium dollar in order to invest. Insurers were able to reduce the price of their product by balancing underwriting losses with investment income until 1984. Lower prices inure to the benefit of the policyholder.

Extraordinary losses experienced by insurers, particularly in commercial casualty lines, have forced insurers to raise premiums dramatically. These premium increases have clashed with the expectations of policyholders, causing hardship among some policyholder groups who rely on various lines of commercial liability coverage.

Many insurers have experienced such financial hardship that they have withdrawn from writing some of the lines of insurance they formerly wrote. This is clearly the case insofar as specialty lines, such as day care centers, dram shop liquor liability, and, to some extent, municipalities are concerned. However, withdrawal from these lines of insurance is, in many instances, also generated by the reinsurance market, which itself has sustained massive financial losses from its U.S. operations.

Insurers and reinsurers are recognizing that pricing and underwriting expectations for many classes of commercial liability insurance have been rendered unreliable because of the unpredictability of future losses.

Judicial misinterpretations of insurance contracts, statutory and common law modifications of the tort system, mandated minimum levels of insurance in federal* and state laws, society's increasing expectation of recovering higher and higher amounts from some "deep pocket" for virtually every injury, have taken their toll on the predictability of losses.* These developments affect virtually all forms of commercial liability insurance, but they especially affect long-tail exposures where the insurer's (and reinsurers') policies can be invoked five, ten, or even twenty years after the policy was written.

The most basic concept underlying insurability and insurance contracts is the concept of risk. "Risk" means literally the "chance of loss" or the "probability of loss." If a loss is certain to happen, then there is no risk of loss to transfer, and an insurance transaction cannot take place. There is a growing perception among underwriters that the accumulation of legal remedies provided under state and federal liability systems are changing a hitherto insurable probability of loss to an uninsurable, virtual certainty. Underwriters are attracted to predictability of loss but must avoid inevitability of loss.

The second basic fundamental of underwriting and insurability is that of predictability. If there is no way to forecast the timing or amount of a loss from past experience, then the loss is unpredictable. Any estimate would be pure speculation.

* Bus Regulatory Reform Act, Motor Carrier Act, Superfund, and the Resource Conservation and Recovery Act.

* -- Ayers v. Jackson Township (N.J., 1983) -- \$15.6 million settlement for alleged waste site injuries.

-- Dietz v. Gray Brothers (Pa., 1984) -- \$750,000 judgment for alleged waste site injuries.

-- In Re Agent Orange (N.Y., 1984) -- \$180 million settlement for alleged defoliant injuries.

-- U.S. v. Olin (Ala., 1983) -- \$24 million settlement for alleged DDT disposal site injuries.

-- Piatt v. Independent Petrochemical (Mo., 1983) -- \$2.6 million judgment for alleged dioxin injuries.

-- LaPoint v. Hooker Chemical (N.Y., 1984) -- \$20 million settlement for alleged Love Canal waste site injuries.

Standard coverage for liability insurance originally applied to bodily injury or property damage "caused by accident". The accident concept was also the time trigger of coverage and the building block of limits of liability. An individual policy covered only accidents which occurred during the policy period.

The classical accident, as perceived by insurance underwriters and policy drafters, was concrete, rather than abstract. They regarded an "accident" as a sudden event of a physical nature that happened by chance at a definite time and place and caused rather obvious injury or damage - a collision of vehicles, a scaffold which broke, a roof which collapsed. "Accident" was not a legalistic concept. The underwriters' conception of "accident" harmonized well with both the classical liability principles of tort law and the fundamentals of insurability. Certainty as to time and place laid the foundation for reasonable predictability.

By 1970, it became apparent that coverage based solely on the classical accident concept was no longer adequate for most insureds. There were true "risks of loss" that did not arise out of sudden causes, but were the result of continuous or repeated exposure to physical causes which resulted in nontraumatic, multiple causation, long-latency diseases.

The extent of exposure for liability insurance coverages has changed dramatically in the past decade. The relationship between low level exposures to useful, but sometimes harmful substances, and injuries to human beings is not well understood today and is still to a large extent speculative. Tort law a few years ago did not concern itself with speculative possibilities of harm. Doctrines of joint and several enterprise liability had not been formulated. It was not until 1974 that the deluge of asbestos-related claims began.

The concept of accident as a single scenario involving one person causing another's harm has changed. Increasingly, recent tort law has applied traditional concepts of individual risk-placing causation and harm into the modern commercial context. The result is that certain communities, types of persons throughout the nation, or classes exposed to risk of harm through commercial enterprises have sought to redress their harm through the liability system and have sought to hold entire industries liable for the creation of

public risks. New types of suits differ from traditional cases in that:

- Injuries are medically complex and have multiple causes, often resulting in the introduction of presumptions into the legal system.
- Injuries have been attributed to exposure over a lengthy period of time.
- Injuries have been applied to groups or classes of claimants.
- Defendants are often a small number of entities or businesses or whole industries involved in certain types of behavior.

The Deep Pockets Report, prepared by the Institute of Civil Justice in 1985, indicates awards differ among types of defendants. Awards against corporate defendants averaged over \$120,000 as against awards for individual defendants of \$18,500. Where injuries were the same, corporate defendants paid 30 percent more than individual defendants. Notably, governmental defendants, which 20 years ago were protected by the Doctrine of Sovereign Immunity, were subjected to an average award of \$38,000.

Certain classes of additional defendants are perceived differently than in the past. The problem of drunk drivers causing an innocent third party's injury has resulted in the expansion of liability to include the provider of the alcohol. In the past, everyone understood that some risk was inherent in any vaccine. However, in recent times, law suits have proliferated against vaccine manufacturers.

Recent court decisions have created new and unpredictable liabilities for property/casualty insurers. As stated in the Villanova Law Review:

- In two recent toxic tort cases, the highest courts of California and New York have held that liability for injuries allegedly caused by DES can be imposed upon defendant-manufacturers without proof that those defendants made DES which caused the plaintiffs' injury. In Sindell v. Abbott Laboratories (1980), the California Supreme Court accomplished this result by fashioning a "market share" theory of liability. Under this theory each defendant was liable for the proportion of the judgment represented by its share of the DES market unless the defendant could demonstrate that it could not have made the product which injured the plaintiff.

Subsequently, in Bichler v. Eli Lilly & Co. (1982), the New York Court of Appeals affirmed a jury verdict against a manufacturer of DES which was based upon the plaintiff's theory that Lilly, in concert with other DES manufacturers, had wrongfully marketed this drug without proper testing. Under this "concert of action" theory, the court in Bichler found the defendant liable for the plaintiff's injuries even though the plaintiff had failed to prove that Lilly--the only defendant named in the suit--was the manufacturer of the DES that the plaintiff's mother had ingested.¹

In both Sindell and Bichler, the rationale underlying the courts' decisions was the same. In both cases, the court was confronted with an innocent victim unable to prove which manufacturer harmed her because of the

¹Villanova Law Review, Volume 28, No. 6, September, 1983, p. 1102-1104.

long latency of the injury coupled with the similarity among the products of the different manufacturers. Faced with a choice between not compensating the victim and holding liable a company which may not have caused the harm, each court chose a theory which would permit compensation of the victim.

Other judicial decisions have weakened defenses based upon the state of the art and technological or economic feasibility. In Beshada v. Johns-Mansville Products Corp. (1982), a manufacturer of asbestos in the 1930's was found to have an obligation to warn of the dangers associated with asbestos products. The manufacturer was not permitted to prove that at the time in question it was not possible to determine the possible harmful affects of asbestos. Prior to this decision, under the state of the art defense, even in strict liability cases, no manufacturer would be held liable for harm caused by conduct or products that could not have been anticipated under state of the art knowledge. This novel decision is a particularly significant finding for chemical product manufacturers because they may be held liable even in instances in which the harmful potential of the product was not discoverable at the time.

Rulings of this type dispense with a fundamental element of the tort system--proof that the defendant was responsible for the plaintiff's harm. Such rulings disrupt the reasonable expectations of both manufacturers and insurers concerning the limits of their liability.

Judicial misinterpretations of insurance policies designed to respond to limited types of pollution exposures have created additional concerns among insurers. Recent court decisions have expanded insurance coverage for cleanup of waste treatment, storage and disposal facilities beyond that which the liability policies were designed to provide. Insurers have lost confidence in the words and phrases of art which have been placed in pollution insurance contracts in order to exclude coverages which may be provided in other insurance policies or which may be properly excluded due to the unpredictable or potentially catastrophic nature of the exposures.

The Comprehensive General Liability (CGL) insurance policy is the instrument used to provide the vast majority of insurance protection for commercial entities from liability for bodily injury and property damage. The CGL insurance policy is a contract between the insurer and the insured in

which the parties define both the risks covered by the insurance and those excluded from coverages. The premium charged by the insurance company relates directly to the frequency and severity of the risk that the company intends to insure. Courts have elected to misinterpret the insurance policy contract language in order to maximize insurance coverage for damages related to hazardous waste.

Some decisions have gone so far as to rewrite policy terms and create coverage which insurers never intended to provide and for which no premium was ever collected. Specifically, we perceive a trend in court decisions that interpret our standard CGL policy to broaden the scope of intended coverage as follows:

- Narrowing the intent of the owned property exclusion to find liability for damage to an insured's property.²
- Overriding the scope of the pollution exclusion so that, for example, well contamination caused by seepage at a hazardous waste site that occurred over a 12 year period was found to be covered despite the policy requirement that coverage be afforded for only "sudden and accidental" pollution.³
- Converting the CGL's policy dollar limit per occurrence into a per claim dollar limit.⁴
- Setting aside the definitions of property damage and bodily injury so as to award speculative damages for the possibility of future harm.⁵

The possibility of similar misinterpretations leading to expansion of coverage in the commercial auto policy exists due to the inclusion of the category of damages for "environmental restoration" in the Motor Carrier Act. Many commercial auto insurers have reacted by excluding environmental restoration from their commercial auto policies.

²See for example, Riehl v. Travelers Insurance Co., ___ F. Suppl. ___, Civil Action No. 83-0085 (W.D. Pa., August 13, 1984).

³See, for example, Jackson Township Municipal Utilities Authority v. Hartford Accident and Indemnity Company, 186 N.J. Super. 156, 451 A.2D 990 (1982). Waste Management of Carolinas, Inc. v. Peerless Insurance Company, 323 S.E. 2D 726 (Court of Appeals of North Carolina, December 28, 1984).

⁴See Township of Jackson v. American Home et. al., Docket No. L-29236-8 (Law Div., August 31, 1984).

⁵Ayers et. al. v. Township of Jackson, 189 N.J. Super. 561 (Ocean County, April 5, 1983).

Concurrent with judicial misinterpretations of insurance contracts, rapidly expanding liability concepts, and the recent drain on insurance industry surplus, the Congress has created a series of expanded responsibilities for insurers and their policyholders by mandating evidence of financial responsibility in a series of recently enacted federal legislation. The Motor Carrier Act (1980) and the Bus Regulatory Reform Act (1982) have mandated large minimum insurance requirements for buses and trucks. In the case of a motor carrier transporting extra-hazardous substances or a bus with a seating capacity in excess of fifteen, the minimum requirement for insurance is \$5 million per vehicle. Although the Resource Conservation Recovery Act was enacted in 1976, the final rule associated with the financial responsibility requirements for waste, treatment and storage facilities was promulgated in 1980. Those financial responsibility requirements have been phased-in over the last 5 years. An additional wave of financial responsibility requirements can be anticipated in association with the Comprehensive Environmental Response, Compensation, and Liability Act of 1980. All of these requirements for evidence of financial responsibility have coincided with the insurance industry's underwriting losses beginning in 1979.

INSURER OPERATING RESULTS

In order to put the present liability insurance problems in perspective, it is necessary to understand the overall financial condition of the insurance industry today. Since 1980, losses and expenses have exceeded premiums primarily because prices failed to keep pace with loss costs. As a result, an unbroken string of underwriting losses began in 1979 and grew at an average annual rate of \$3 billion through 1983. An even more dramatic increase took place in 1984 when underwriting losses jumped \$8 billion, reaching \$21.3 billion. Losses from underwriting for the six years 1979 through 1984 totalled \$55 billion. With investment income falling far behind underwriting losses, the industry's pre-tax operating income - the combination of investment income and underwriting results - plunged to a negative \$3.8 billion in 1984. Operating losses for the first nine months of 1985 have exceeded \$3.5 billion.

The commercial liability lines experience has been particularly negative. Four key commercial lines - general liability, commercial multi-peril,

workers' compensation and commercial automobile - have suffered enormous underwriting losses. General liability leads all lines of insurance with the highest combined ratio of 152.

As a business, the industry cannot afford to indefinitely price its product at less than cost. As stated by the Insurance Services Office:⁶

The decline in surplus and questions as to adequate loss reserves have raised concerns about the solvency of many insurers. In 1984, at least 22 property/casualty insurance companies were found to be financially impaired. Most of these companies were insolvent. Additionally, several sizable insurers were placed in rehabilitation by regulators with an indication given that liquidation could not be avoided. In total for 1984, companies accounting for more than one fifth of industry premiums failed 4 or more IRIS tests. As of mid-November 1985, 38 companies have become insolvent since the beginning of 1984. That is more insolvencies than in any full two-year period since guaranty funds were formed, and the books aren't yet closed for 1985.

A.M. Best Company annually conducts a specialized financial analysis of most United States insurance companies and expresses its evaluation in the form of a rating. All companies rated "Excellent" are considered to be outstanding and have no material unfavorable variances from A.M. Best's averages. Lower ratings reflect increasingly unfavorable variances from A.M. Best's industry standards. An "Excellent" rating is considered essential if an insurer wishes to do business with top U.S. corporations, municipalities and government contractors.

From 1982 to 1983, 30 companies' ratings were upgraded to "Excellent" while 78 companies' ratings were downgraded from "Excellent". In 1984, there were 38 increases to "Excellent", but 150 companies received rating decreases from this level. When the 1985 ratings were issued, 25 companies had an increase in their rating while 331 companies saw their rating drop.

The declining solidity of the property/casualty industry is also illustrated by what is termed the exposure ratio, defined as the ratio of net written premiums to surplus. The percent of industry premiums written by companies with high exposure ratios has increased dramatically. The National Association of Insurance Commissioners (NAIC) has selected a premium-to-surplus ratio of 3-to-1 as a maximum. Any insurer writing above this level fails the premium-to-surplus test. While only 4 percent of the industry's premium was written by companies with a premium-to-surplus ratio above 3-to-1 in 1982, by 1984 that increased to 15 percent and estimates are that it will exceed 20 percent by the end of 1985.

While the financial results of the property and casualty insurance industry are partly the result of a competitive pricing cycle, the industry has also come to recognize that it has become a victim of fundamental changes in the civil justice system during the past decade. More and more, insurers have encountered court interpretations of prior insurance contracts which expand coverage beyond that which insurers intended. As a result, the availability and cost of insurance for current liability is significantly influenced by: insurers' concern about potential unanticipated past liability; the magnitude of potential liability, both past and future; the seeming inability to use contract language to prudently limit insurers' exposure; and a civil justice system that continues to create new theories of liability and to expand older theories.

⁶Financial Condition Of The Insurance Industry-An Update

VOLUNTARY SOLUTIONS

The American Insurance Association has thus far categorized pollution liability and asbestos abatement contractors' liability as falling into the unmanageable or uninsurable category. In addition, there are a number of availability problems in lines that are badly damaged by the liability system, but there is still a potential that insurers can provide coverage.* In these areas ATA will work actively with its companies, other trade associations and state insurance commissioners to explore voluntary Market Assistance Programs or other market solutions to the problem. A Market Assistance Program (MAP) establishes a central administrative point where a buyer who is experiencing difficulty in purchasing insurance may come in order to be referred to one or more participating insurers who employ their established underwriting criteria and rating plans. A MAP can also serve to gather information about real or perceived availability problems and be a focal point around which the insurance department, buyers' groups, agents and brokers may discuss availability problems in a constructive manner.

It should be emphasized that merely shifting the burden from one insurance mechanism to another does not address the key problem associated with availability/affordability of liability insurance. Artificial, involuntary insurance mechanisms such as Joint Underwriting Associations mask the underlying problem. The answer to this dilemma has been and remains tort reform. There is a tendency among some regulators and legislators to adopt the expeditious approach of forcing insurers to write insurance coverage, either on an assigned risk or a pooled basis. This solves the immediate availability problem at no apparent cost to the public treasury and with no need to address the difficult task of reforming the tort liability system.

Structuring alternative insurance mechanisms addresses a symptom rather than the cause of the current commercial casualty insurance availability and affordability situation. Although alternative insurance mechanisms may be necessary in order to respond to federal and state financial responsibility requirements, a thorough review of common law decisions and state and federal statutory liability concepts is essential if commercial casualty insurance is to be both affordable and available in the future.

* Day Care Centers, Liquor Liability, Directors and Officers, Physicians Malpractice Insurance, Nurse Midwives, Commercial Auto Insurance (Long Haul Trucking Companies and Bus Companies), Rural Homeowners Insurance.

Senator McCONNELL. Thank you. As I indicated earlier—you may have been here—there will be two additional hearings on the 25th and the 26th of March and quite possibly you would be able to finalize your position on those bills prior to that time.

Ms. Walters, I had prepared several questions here to ask you with regard to the data that a lot of us have been seeking. I assume those answers are going to be provided in this study that you made reference to that is going to come out in a couple of weeks, for example, data that demonstrates the increase the companies are experiencing in claims litigation costs and other factors associated with the tort system and so on, the various—

Ms. WALTERS. To some extent. There will be a lot of data, a lot of charts, graphs, exhibits in that document. On the question of data, I would like to point out that the property-casualty insurance industry probably has available in files publicly or with various sources more data, more statistics and more information than any other industry in the United States.

The property-casualty insurers file financial information with insurance regulators in their annual statements to assist the regulators with their primary responsibility which is to monitor for solvency and solidity. Insurers file statistical information with licensed or accredited or accepted statistical agents around the country and this statistical data is filed in conformance with classification plans so that regulators and others can assess whether or not the premiums, the losses, the claims are in accordance with the classification plans.

Senator McCONNELL. Then it should be fairly easy to supply the information we are asking for.

Ms. WALTERS. Well, what I am suggesting is that there is so much information that not all of this obviously is going to be in the document that we are presenting to you. We do have and I would be very happy to make available to you—

Senator McCONNELL. When can we expect to get that sort of information?

Ms. WALTERS. I can provide Monday some information on the specific classes that have been the subject of in fact a great deal of discussion this morning, such as municipalities, day care centers—

Senator McCONNELL. I think you need to do that because there is going to be a movement clearly here, I think it is obvious there is going to be a movement here to change the status of the antitrust exemption or begin to provide some kind of Federal regulation and a whole lot of other things that I would assume your industry is not too excited to get into—

Ms. WALTERS. I am sure Mr. Kimble would—

Senator McCONNELL [continuing]. And the best way to avoid that it seems to me is to provide the data that a lot of us who are not leaning in that direction at all would like to have.

Ms. WALTERS. I would like to make two comments on that, if I could, about the data. We have, as I said, lots of data and lots of information available on what we know are the problem classes and I can make that—that has been prepared and we have been sending it to anyone who has asked, so I would be very happy to make that available to your staff as early as Monday.

Senator McCONNELL. We have been working on this for about 4 months. I do not know if we—we have some but not much.

Ms. WALTERS. Yes. Let me make another point about data too, though, so that people can understand a little bit more about what is going on.

We are looking at in many cases insurance premiums today and insurance companies are trying to determine what premiums they need to charge today. Some have used the crude analogy that I think is perhaps a fairly good one. We do use data over the most recent past, that is the primary source of information that is available but it is not the only thing that we should look at.

It is somewhat analogous to driving a car by only looking out the rearview mirror. Looking at past data tells you something, but it does not tell you everything, and let me be very specific and give you three examples of why we also have to—when I say we, I am talking more about the company underwriters as well as actuaries to some extent using judgment in determining premiums and evaluating where you are today—three specific cases.

Municipal liability: We can look at the actual claims experience for the different municipal liability costs, but in any given State if there has been a court decision, even as late as last month or last week or last year, which has thrown out or abandoned sovereign immunity, then obviously all the experience of the past which was gathered when there was sovereign immunity is useless in terms of predicting what the claims environment is going to be in the future.

Let me give you another real example—Mr. Kimble referred to it—environmental impairment and pollution liability and the commercial general liability coverages in general.

We had what was called at the time comprehensive general liability insurance policy with rather clear language that insurers believed stated their case very clearly that we will not cover a pollution incident unless it is sudden and accidental, and then you get a court case which interprets something which is gradual or occurs over a long period of time and interprets that as being sudden and accidental and we realize all of a sudden that the data of the past is now totally irrelevant because this has changed.

Let me make one more example, and this may get into an area that you want to discuss a little bit more, too—we discussed it at some length this morning—the problems with day care and that class of business.

The data we have, which I will give to your staff, does show that for the day care class of business in fact, the claim costs have been greater than the insurance premiums, but those data by and large—because there is a lag in ratemaking data—do not even reflect many of the more recent claims which deal with physical or sexual abuse.

But what we are dealing with here is something in the whole day care area which is really a profound change in the structure of the insurance business, all of it is coming into play in the day care class. Let me be specific. There are problems with this class of business.

One of the reasons is a major insurer or, rather, an insurer which had been a major insurer of that class of business, they had

specialized in providing day care coverage, is insolvent. I guess it was in mid to late 1984, they went insolvent so obviously all of the business which they had written was canceled. The company went out of business.

That happened at a time when capacity and surplus have been severely strained in the industry. Other commercial carriers who have not made it a practice to write that business were left with trying to deal with it. This is all coming at a time also when the fundamental exposure being insured, everyone realized had changed.

When day care coverage had been provided under whatever source of contracts in the past, I do not think anyone contemplated, I do not think parents did, I do not think day care operators and certainly not insurance companies contemplated that we were going to see the kinds of incidents that have actually occurred, the sick, horrible things that you would not want to happen to anyone's child. No one contemplated this.

In fact, insurance contracts historically have all been very clear that you do not cover intentional, criminal, or unlawful acts, but yet there were ways found to get around it. All of this was happening at the same time.

One positive note I would say in this area is that there have been enormous efforts made at the State level, voluntary efforts in dealing with the marketplace, insurers, agents, the State regulators, to address this problem. In fact, there is a major insurer who has now filed countrywide a specific day care program that they have worked out with representatives of the day care community.

Senator McCONNELL. Thank you. I saw you shaking your head when Mr. Angoff suggested that the industry pays our far less than it earns. What do you say about a situation like in New Hampshire, where claims are few and costs are just as high?

Ms. WALTERS. Several of the things he said were just slightly wrong, and others were partially true. It is not true in New Hampshire or any other State that costs have gone down. I have not looked at day care experience in New Hampshire, and I do not know whether he has looked at day care in New Hampshire, but I suggest that one of the problems that we are all dealing with—and when I say all, I mean more the community as people, not just insurance companies—is, if you think again of my analogy of the car and just looking in the rearview mirror, we know the exposure, that which is being insured is much different than it was before. That additional risk element has got to be taken into consideration now in providing this type of coverage.

Let me comment if I could, it might help you to clear up some questions you have in your mind, on the question of homeowners insurance coverage. Every homeowner's insurance policy, virtually every homeowner's insurance policy that is issued today has a very clear statement in it, an exclusion called a business pursuits exclusion and I think it is perfectly reasonable, if everyone agrees, those who buy homeowner's insurance for our home do not want to pay for the losses of those who run businesses out of their homes.

So to some extent, when the problem started to arise and underwriters and parents and State officials started to recognize some of

the difficulties in the day care area, insurance underwriters started to look at this too and say:

Gee, do we have day care provisions or providers or are we providing for day care coverage under our homeowner's insurance when it is not intended to be provided there because there is a business pursuits exclusion, or do we not and we have got to mesh those things so that we are not providing commercial insurance coverage under a homeowner's insurance policy.

I think that has created a little bit of the marketplace dislocation and I think it is going to be taken care of because in essence I think it is a temporary dislocation.

Senator McCONNELL. Well, one of the things that the industry needs to help us do is to quantify what proportion of the problem is attributable to the court system, otherwise we can only assume that there is some other cause for the astronomical increase in premiums or the unavailability of insurance altogether.

The industry generally cut its premiums in 1980 and 1981 when interest rates were 18 to 20 percent. Where would the industry be today if those rates had remained high?

Ms. WALTERS. I always have a tough time answering what if questions. I can honestly say two things—

Senator McCONNELL. Just try that.

Ms. WALTERS. I will. It is clear, as I say in my formal statement, that no one can deny insurers—I would not say, as Mr. Angoff did, that they insure bad business. That is not the point. The point is the insurers lowered prices in the marketplace competitively for about a 5- or 6-year period, and we might—I might also add that the businesses who were buying insurance during that period of lower prices, of course, were not being harmed.

But at the same time my formal statement has some allusion to it and it will be covered at length in the document I referred to. We do know that losses most recently have been increasing at a far greater rate than is normal, predictable or usual.

Something has been causing paid losses, actual lost dollars to go up at a far greater rate than the GNP has gone up, and this can be documented clearly in the material that should be ready by—

Senator McCONNELL. That is precisely what we need.

Ms. WALTERS. I think that will be very, very helpful.

Senator McCONNELL. That is the whole question that you need to answer, particularly for people like Senator Simon who think that this solution to the problem may well be to change the antitrust exemption.

Ms. WALTERS. That is the other point, if I could make one more comment on the antitrust, and Mr. Kimble may want to comment on it as well.

Mr. Simon talked about the need to deal with the antitrust or *McCarran-Ferguson* because he said companies can agree not to insure or agree to change the same price. Now, in theory one cannot disagree with that statement, but in reality what has been going on in the past 5 or 6 years has not resulted or been the result of cartel-like behavior or anticompetitive behavior. It has been quite the opposite.

The literally 3,000 property-casualty companies who operate in the United States have been competing very, very, very aggressively and lowering prices, not all agreeing to charge the same price.

So while there may be lots of valid reasons for taking a look at the *McCarran-Ferguson* exemption, I would respectfully suggest that it has nothing to do with the problem at hand here.

Senator McCONNELL. At least partially, because we have dragged along here quite longer than we anticipated, what I would like to do is ask one more question of you, Ms. Walters, submit some questions to you, Mr. Kimble, and then get to Mr. Schwartz.

What are we to conclude, either of you, when we see the stock prices for insurance companies rising far faster than the stock market generally? Hasn't the investing public demonstrated its belief in that the industry has no financial problems?

Mr. WALTERS. No, I do not think that is a fair conclusion at all. In my opinion, the movement of stock prices reflect investor expectation. They certainly do not guarantee results. Certainly, investors are expecting improved profitability for the property-casualty insurance business. It could hardly be otherwise; with a 1.7-percent return in 1984 and with a projected return in 1985 of no greater than 4 percent, it is not surprising that investors are expecting insurance company profitability to improve.

Insurance companies are expecting and hoping that their profitability will improve. It certainly does not guarantee results and it certainly does not prove that insurance companies are profitable to any degree, much less excessively profitable.

Senator McCONNELL. Mr. Kimble, did you want to make an observation?

Mr. KIMBLE. It is an indication that we are doing what we must do, which is to raise premiums. Institutional investors are capable of looking at the underwriting cycle. They understand that the underwriting loss portion of the cycle is entering its 6th year, and their judgment is that because we are raising premiums that cycle will turn around and we will return to a more profitable condition.

Senator McCONNELL. I want to thank both of you very much for coming.

Our final witness—and I apologize that we have gone on as long as we have—is Victor Schwartz, a partner in Crowell & Moring here in Washington. He is coauthor of "Prosser, Wade, and Schwartz, Cases and Materials on Torts." All of us who went to law school are familiar with Professor Prosser.

Mr. Schwartz serves as counsel to the Product Liability Alliance, a consortium of manufacturers and businesses dedicated to the reform of the product liability laws. He served as chairman of the Working Task Force on the Federal Interagency Task Force on Product Liability.

We are very happy to have you here today, Mr. Schwartz. The staff points out that you are not only testifying on your own but not as the representative of that Product Liability Alliance.

STATEMENT OF VICTOR E. SCHWARTZ, A PARTNER IN CROWELL & MORING

Mr. SCHWARTZ. I thank you, Mr. Chairman, for your kind invitation. I taught law school for about 15 years and it took me a while to get tenure, and until you got tenure, you had to have your class

right before lunch hour, and I learned during that time to be brief, so I will, thinking back to the past be brief today.

I thank you very much for your inviting me here today and, as you suggested, I am just testifying today based on my own experience. I have spent most of my adult life as a law professor and acting dean of a law school. As you mentioned, I wrote some text and articles. I spent almost 5 years in the Government as chairman of the Federal Interagency Task Force on Product Liability, and also chaired the Federal Interagency Council on Insurance. The council studied a variety of problems, some similar to the current crisis that came up during that period of time.

In the past 5 years, I have been a partner in Crowell & Moring. I have 14 people in our torts and insurance group. We represent both defendants and plaintiffs. While most people think of us as defense counsel, last year we recovered over \$2 million on behalf of injured persons.

So what I am saying today is really based on that experience. Some witnesses have suggested that the answer to the current crisis can only be found by looking at claims data. It is hard to find data. There will be a data hunt. If one looks at the tort law and the changes that have occurred data.

When I began teaching in 1966, tort law was some remote part of the law. It was used to introduce students in law schools to a subject where they would be familiar with the fact patterns that arose. It could be the richest kid in the community or the poorest, but they all had seen or heard of an automobile accident, the punch in the nose, and things like that. It certainly was not national headlines as it is today.

So something must have happened. I see it as a 4-inch rusty pipe, and all of a sudden, people put about a thousand pounds of water in it and it is bursting and it is not surprising that things are going amiss.

There has been a jump in product liability cases filed in Federal courts, 1,500 in 1974 to over 10,000 in 1984. In the past 5 years, the Westlaw reporter shows in State courts a jump in cases increasing over 50 percent.

Apart from the size of claims and the number of claims, we have an increase in the amount of money that is being siphoned off the system. A study of asbestos cases conducted by the Rand Corp. shows that defense attorneys are getting approximately 59 cents for every dollar going to a victim and a plaintiff's lawyer getting 41 cents. That is much too high.

Every survey that we have seen shows that the lawyers are getting more than the victims. Apart from the increase in costs, there is wide disparity of claims. If you take a look, even a glance at jury verdict research, you will see the same injury and the same situation, disparities between nothing, \$4 million, \$300,000 for the same precise thing.

We may blame the courts for this crisis, and it is easy to do, but courts are looking at cases as they come up one at a time. They hear two attorneys. They do not get the big picture, so we really cannot hold them responsible for a situation that is the big picture. It is the legislative forum that can look at it, that can get the wit-

nesses and get the information to look at the overall system and see if reform can and should be done.

Some of the courts have been motivated by concern for victims. It is clear, if you read the decisions, that is true. Tort law in the minds of some courts has almost become a substitute for national health insurance and they have fit in this old 4-inch pipe a lot of things that were never intended to pass through it.

The word "tort" means wrong, and yet courts today hold people who are innocent liable. They are doing this not out of any sense of vengeance but a sense of a need to compensate injured people.

There have been many hearings on this subject. Senator Danforth right now is holding hearings on product liability. I am not going to discuss details of those bills. I see the bills that you have introduced as complementary to what Senator Danforth is doing and your bills cover very worthwhile topics.

Very briefly, I will discuss those topics: Litigation abuse, the contingency fee, the collateral source rule, damages for pain and suffering, and joint and several liability and punitive damages.

Let me discuss litigation abuse briefly. Our task force, the Federal Interagency Task Force on Product Liability, found that there was litigation abuse. We found that lawyers, a small band of lawyers, not a lot, were bringing cases which they knew to be groundless and somehow, almost as if their minds were calculators, they would estimate what the defense costs would be and they offer settlement amounts that will be below what the defense costs will be, even though the claims are totally groundless. They know it and the defense attorneys know it, but in light of the costs they can get \$5,000 here, \$10,000 there, and, to paraphrase the man this building is named after, pretty soon it ends up to money—he used "a billion here, a billion there."

In S. 2038, you have provisions that will require strong remedies for frivolous claims and also frivolous defenses. The defense part should not be ignored here because defense costs run like taxi meters, where they are going all the time, even when the attorneys are standing still, their meter is running. They do not have the zone system like in the District and so—

Senator McCONNELL. Pay by the pound.

Mr. SCHWARTZ. You bet—and there are dilatory practices on their side and S. 2038 addresses that and I think that is an avenue that should be pursued further on both sides of that aisle.

Let me briefly address the contingent fee. I think there is a problem with the name of the contingent fee today, in 1986. It suggests too much change. Twenty years ago, when I began to teach this subject and learn about it, there was a lot of chance in outcome, but today many plaintiff's cases, I have brought such cases, the outcome is virtually certain: There will be liability, the dispute is really over damages.

If you have an individual, for example, who has mesothelioma, who was clearly exposed to asbestos of a company that is currently in business and viable, you have a liability case. There is no contingency at all. So the old myth that the winners have to make up for the losers does not exist today as much, and contingent fee recoveries can be exorbitant.

Having a sliding scale approach is a very worthwhile thing to pursue and examine. A few States have employed a system similar to that set forth in S. 2038. When this was first raised in New Jersey, the organized plaintiffs bar said if we put in a sliding scale in the State, the poor will not get lawyers and ultimately no one would get lawyers. The last time I was in New Jersey, I slipped coming out of the airport and there were six lawyers who gave me their cards before I fell down. [Laughter.]

There are plenty of plaintiffs' lawyers active in New Jersey, in spite of the sliding scale being in existence since 1974.

Reform in the contingent fee I think should go beyond the sliding scale. Let me just share with you again a personal experience. I represent both defendants and plaintiffs. There is a startling difference between these two groups.

The defendants are generally educated people who understand lawyers, who understand their bills, who make reasonable demands but deal with you on an equal basis. You want to have continuing business with them. You promptly return their phone calls.

The plaintiffs, on the other hand, are often not as educated as the attorneys. They are unfamiliar with the legal process. They are not people who you are going to deal with on a continuing basis. They are injured. They are suffering, and there is a total inequality of bargaining power between them and their attorney.

Picture what goes on in some of the shops around this town and across the Nation. A person is handed a piece of paper, it is complicated, he has never seen anything like that before. It is called a contingent fee. He may not even fully understand what it is. It says that his recovery will be "35 percent plus costs," often costs are not defined. What are costs? Is it depositions, is it phone calls, is it photocopying?

I think that people are entitled who use plaintiffs' lawyers to more information than they get today. They ought to get information about the probability of the outcome. They ought to get information about the size of the outcome. They ought to get information about what costs are.

When you go to a bank to borrow money at 14 or 15 percent, you get information that is many pages long. But when you go to a plaintiffs' lawyer, you do not. Funeral directors and used car salesmen provide more information.

I think the bar associations can work on this, the State level organizations can work on it, but a spotlight in Congress on this problem will help bring about more fairness in the contingency fee system and how it works.

Let me discuss briefly the collateral source rule. The collateral source rule is the total mystery to most laymen. If you talk to a hundred of them and not one of them is going to know what it is. But pure and simple, what it is it is a rule that says when you bring a lawsuit against somebody and you say you have lost \$100,000 and you have already received back \$80,000 from your health insurer or from your employer, the jury is not permitted to know about it and you can collect all of that money again. In other words, it provides a duplicate payment.

Many courts, when they view a situation, seem to assume that the plaintiff has not been paid by any other source, but the fact is

that the Statistical Abstract of the United States show that 90 percent of Americans have some form of health insurance so some payment has already been made.

We are in a time where economic efficiency has become a necessity. An examination of the collateral source rule which provides for duplicate and unnecessary payment is very worthwhile and I am pleased to see it addressed in the bill. It is totally unjustified to have the collateral source rule when a person is not a wrong-doer, and yet that is done in many, many of our courts today.

The basis for the collateral source rule is the assumption that a wrong-doer, somebody who has been at fault should not benefit from the fact that the plaintiff has been provident and has bought insurance, yet courts willy-nilly today apply this same rule in strict liability. It is simply a total waste of resources, it is inefficiency of outcome and the whole basis of the rule is not even there.

Let me briefly discuss damages for pain and suffering. If one goes to the history of tort law, way back in the old books, one is going to find that the damages for pain and suffering rule originated on the basis of fault. They were sanctions against a wrong-doer.

During the 20th century, plaintiffs' lawyers transformed the nature of pain and suffering damages from a wrist slapping focus into a compensatory focus. So when Mr. Angoff spoke earlier, he is thinking it is there to compensate, yet any studies that have been done—and Cornelius Peck of the Washington Law School did the best one—show that the fact that somebody gets money does not alleviate pain. They do not feel better. It does not help their symptoms.

Right now pain and suffering damages are distributed on a very uneven basis. One can even out the distribution by use of a reasonable cap.

Let me very quickly discuss that is called by some law professors, "the calculus." Believe it or not, it was first thought of back in 1917 by a famous torts professor named Terry. Terry said pain and suffering damages are arbitrary, the collateral source rule is arbitrary, but we need them because the plaintiff has to pay his own attorneys fees.

Let me put it another way: If you gave the plaintiff his true out-of-pocket costs, Terry said, he would not end up with them because he had to pay his lawyer, so we have these other things to make the award more inflated than necessary so that a poor person can afford to pay his lawyer. That is known as the calculus.

But the calculus is arbitrary. The calculus is not in congruence with reality. Sometimes a plaintiff gets way too much and other times he may not get enough. The best way to approach it is to do exactly what your bill does and examine the fairness of the collateral source rule, examine the fairness of pain and suffering rule and examine attorneys fees separately so that the award the plaintiff gets is much more congruent with what he actually needs, rather than use these rules that have been around since the early 1900's and have become totally out of sync today with reality.

Joint and several liability, where did that come from? Well, common law courts did not like to apportion fault. Any of you who are lawyers here remember that in the old days when a plaintiff was even slightly at fault he could not win his case. That was the

contributory negligence rule. But today in most States, including your State, Senator, there is comparative fault, comparative negligence. But when courts took on comparative negligence and comparative fault, they still kept the rules as to joint and several liability. In fact, they made them worse.

So somebody who is 3 or 4 percent at fault today can absorb 100 percent of liability, even though the jury has made the apportionment. That is how we know he is 4 percent at fault. It is rife with unfairness. A plaintiff who is lucky enough to be able to find somebody somewhere who has a deep pocket and can haul him in with marginal fault is able to recover more money than another person who may be suing a defendant whose conduct has been absolutely abominable.

So it is an area calling for reform, it is an area calling for adjustment, and it is an area where courts have failed to do anything.

Punitive damages: Punitive damages came in our law because the sheriffs of England were just too busy. There were murders, mayhem, arson—we think we have problems today—to some degree, the good old days were worse, so there was no time to do something about somebody who was punched in a bar or some woman who was jumped and assaulted on the street. They were too busy worrying about the murders, mayhem and arson, so tort law took on a punitive role and became an auxiliary to the criminal law.

Today, punitive damages are asked for in many cases and yet when you go to try to count successful claims I think you are not going to find that many. But the heart of what is wrong in the punitive damage system is it has become a device for abuse. In almost every case, the plaintiff asks for them and the reason he does—and I would when I take a plaintiff's case—is it allows you to get in front of the court certain evidence that you otherwise could not get in.

For example, you can show the defendant's wealth. Now, you may know you are not going to win your case but putting in front of that jury that General Motors or Abbott Laboratories is worth so much money gets those facts in the jury's mind. Does it really help at the end of the case when the judge says "now the fact that it was shown that X corporation is worth \$3 billion is not to be considered by you unless you decide punitive damages are to be awarded." I do not think so.

Jurors' minds are not like a magnetic tape, they remember the \$3 billion, and often overlook the liability facts, whether the defendant was wrongful or not, in light of the fact that that evidence has been brought before them. It is an area for reform.

I would be cautious in simply switching punitive damages over to the Federal Government or some other fund. I think that has to be approached very, very carefully because you can create a conflict of interest on the part of the attorney bringing the case, is he really working for the Federal Government, is he really working for the client, and it is an area that deserves careful consideration.

Senator McCONNELL. To whom would you have the award, the damage award?

Mr. SCHWARTZ. I think that part of the award must go to the individual who was injured and also filter into the contingent fee to

allow an appropriate incentive for punitive damages to be awarded, to be brought in appropriate cases, but a portion of it could be going to Government or listed charities.

There were some bills earlier where they did not list the charities, it was very openended provisions and Senator Heflin did a marvelous job talking about a cat fund where all the money went to. I never forgot that. So I think if the funds are going to go to certain private resources, charities, health organizations, they should be listed. If it is to the Government, they should be used for the promotion of safety and health with specificity as to where that money should go.

In conclusion, I would observe that the organized plaintiffs' bar, and unfortunately some consumer groups that I think—it is just my opinion—have been caught in their embrace, suggest that the legal system is working perfectly. It is not.

Cases take far too long and precious resources are being wasted in trying and settling them. The system does not benefit the victim and it does not benefit defendants. The principal beneficiaries of our system may be the organized bar.

The fact that claimants' attorneys have been able to bond themselves with some consumer groups I think is tragic. The interest of the average person who must pay these costs—for example, 18 percent of the price of a ladder is product liability insurance today—and deal with this system is forgotten.

I am hopeful that the approach you have taken, which is not to deprive victims of their claims, but to facilitate the operation of the system and make it more responsive to all people's needs might receive support and assistance in the development of the legislation from all segments of our society.

It is of great benefit to the hundreds of thousands of people who have to turn to our court system that you are looking at this subject. As I indicated earlier, courts just look at the cases before them. They do not look at the overall picture. That is why hearings by the Judiciary Committee will help.

As you can probably tell by my statement, I am dealing with a subject that I really love and I enjoy its intricacies, but it is an area that right now calls for reform and I am glad you have an interest in the subject.

Thank you.

[The prepared statement of Mr. Schwartz follows:]

TESTIMONY BY
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PARTNER
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WASHINGTON, D. C.

Mr. Chairman, thank you for your kind invitation today to discuss the current liability crisis in the United States as well as your recently introduced legislation, S. 2038, the Alternative Dispute Resolution Promotion Act of 1986, and S. 2046, the Litigation Abuse Reform Act of 1986.

I want to begin by commending you, Mr. Chairman, for recognizing what has become the Number One economic problem affecting interstate commerce. In the past month alone, it has been the focus of a cover story in Fortune Magazine, U.S. News & World Report as well as countless other periodicals. The press has recognized the fact that this is a complex problem, not subject to easy or quick baked solutions.

Let me share with you briefly my background in the liability area, for I testify today not on behalf of any organization or interest group, but solely on the basis of that background. I have been active in the field of tort liability law for twenty years. More than half of that time was spent as a law professor and dean of a law school. I am co-author of Prosser, Wade, and Schwartz, Cases and Materials on Torts, which is the most widely used torts case book in the United States of America today. I have also had the opportunity of writing many articles on the subject. For almost five years I viewed this subject from the vantage point of the Federal Government. I chaired the Federal Interagency Task Force on Product Liability and the Federal Interagency Council on Insurance. The Task Force studied the product liability problem that arose in 1976, and the Council coordinated insurance policy among 12 agencies. For the past five years, I have been in practice as a partner at Crowell & Moring and co-chair a 14-lawyer group that is active in litigation in this area. We have represented both injured persons and defendants. I have also served as counsel to a variety of groups that have an interest in legislative tort reform.

What has happened to the tort field over the past twenty years? Obviously, a great deal. When I began to teach this subject

in 1966 it was a truly "academic" course given in the first year of law school. Its main purpose was to introduce students into the law, and it was used because the factual situations the law of torts deals with are familiar to almost anyone. How has this "academic" area of law changed and become front page news and a major crisis area for our economy? If I may be permitted a metaphor, tort law was like a four-inch pipe handling a flow of accidents and injuries. But suddenly, courts reached out and began forcing more water through the pipe. Today, we have thousands of pounds of water pressure in this narrow pipe -- it is no wonder that the pipe has burst and is leaking in many places.

In the Federal courts alone in the area of product liability we have seen a jump from 1500 cases filed in 1974 to over 10,000 cases filed in 1984. In the past five years, reported product liability cases brought in state courts in the "Westlaw" service have increased over 50 percent.

Apart from increases in numbers of claims, the cost of litigation appears to be going higher and higher. The Rand Corporation has indicated that in asbestos cases it costs defense approximately 59 cents in defense attorney fees for every dollar that goes to a victim. Of that dollar the victim receives, plaintiffs' attorneys take 41 percent. It is crystal clear from all surveys that lawyers are getting far more money than victims in tort cases today.

Apart from increase in costs, there is wide disparity of result for similar injuries. We will follow up with supplements from jury verdict research, but I can assure you, the same injury can bring a million dollars, \$4 million, \$300 thousand, or nothing.

We may blame the courts for this crisis. They have lost sight of the purposes of tort law and the consequences of their decisions. But one should not be too quick in admonishing our judiciary. They have looked at cases individually on a case-by-case basis. But, they did not and perhaps could not step back, as you can in a legislative role, and look at the forest instead of the trees. Some of the courts have been motivated by a concern about the fact that we do not have some type of national health insurance and have turned to the tort system as the ultimate means of compen-

sating people who are injured. But anyone who has made even an initial study of the tort system can recognize that the tort law damage system was not intended to be purely compensatory in nature. The tort system is based on fault -- its very name, tort, means "twisted" or "wrong".

While there has been focus before other committees on standards of liability, notably Senator Danforth's efforts before the Senate Commerce Committee, the bills that you have introduced provide a worthwhile, complimentary effort in focusing on the procedural and damage rules that affect tort law.

Taking guidance from your bills, I will focus on six of those topics today: litigation abuse, the contingency fee, the collateral source rule, damages for pain and suffering, joint and several liability, and punitive damages.

Litigation Abuse.

When we conducted the Federal Interagency Task Force on Product Liability study, we found that abuse of the litigation system was, indeed, a problem. As a means of addressing that problem, we included in our Uniform Product Liability Act a provision based on frivolous claims and defenses. My years in practice have illustrated that this is, indeed, a serious problem. A small, but virulent group of plaintiffs' lawyers know that they can bring the wildest of claims, i.e., a recent claim brought against an automobile company where a woman alleged that the automobile company should be subject to liability because it did not warn on the outside of a car trunk that it could not be opened from the inside (she had attempted suicide by locking herself in the car in a closed garage). This band of attorneys knows that defense costs can be quite substantial. Therefore, after bringing the suit, they may be able to pressure \$10,000 here, \$20,000 settlements, simply as a "payoff" for avoiding an expensive trial. Even when the defendant wins, he loses when trial expenses for a chemical toxic harm claim runs to more than \$100,000. Sometimes, several times this amount. We need strong and effective rules that will impose the full cost of litigation on persons who bring such claims. And we need judges who will enforce those rules. Provisions in S. 2038 will help bring about that result.

We also should impose sanctions against defendants who engage in needless delay and clear dilatory practices. Again, awards of attorney fees are a good sanction. If defense attorneys know that these will be imposed, they will hesitate before engaging in needless delays.

The Contingency Fee.

One basic problem with the contingency fee today is its name. It suggests, looking to the definition in Webster's Second University Dictionary, that it is "conditional" or "happening by accident or chance". To the contrary, in many tort cases today, "chance" is reduced to zero. Liability is virtually certain. An example might be a case of a person who has mesothelioma and worked for a period of time with asbestos.

Because contingencies have been reduced, the old maxim that the awards must be very substantial so that the "winners can make up for the losers" is far less true today than it was twenty years ago. If one combines the reduction in uncertainty with the new and substantially increased amount of damages, one can appreciate why a number of states have instituted sliding scale fee arrangements as is set forth in your legislation, S. 2046.

One of the arguments that plaintiff's bar has made against such an arrangement is that it will impede the ability of poor people to obtain lawyers. Nevertheless, in states that have instituted them, this has not occurred. In that regard, it is curious that this is the very argument that the organized plaintiff's bar made in front of the Supreme Court of New Jersey back in 1974, see American Trial Lawyers Association v. New Jersey Supreme Court, 66 N.J. 258, 330 A.2d 350 (1974). The court rejected the argument and actual experience has proven it to be totally invalid -- there is an ample supply of plaintiffs' lawyers in New Jersey.

In order to be fair, sliding scale rules should permit plaintiffs' attorneys the right to seek courts to review awards to assure that they are adequate. There can and have been cases where a sliding scale might arbitrarily reduce the amount of the plaintiff's counsel fee.

Reform in the contingency fee area should go beyond sliding scale. In that regard, one matter I have come to appreciate in

practice is the strikingly different relationships one has between plaintiff clients and defendant clients. Defendant clients are persons who have educational and economic advantages that are equal to their lawyers. When they review their detailed bills, they know very much what they are doing. There is total "equality of bargaining power." In fact, if there is any tilt, it is clearly toward the client. Defense lawyers want to have a continuing relationship with that client and work hard to please them. By way of contrast, when one deals with an injured person, it is usually "a one shot deal". Again, by way of contrast, they may be less educated than their lawyers and, in contrast to business client, far less knowledgeable about attorneys' fees and litigation. Finally, to make bargaining power arrangement even more unequal, they are seriously injured or have recently lost a loved one because of a personal injury. If one can picture the situation between a plaintiff lawyer and his client and what occurs, one can appreciate the dire need for reform. Frequently, the client is given a rather succinct "contingency fee arrangement" agreement. It indicates that 33 percent or so of the ultimate award will be the lawyer's fee "plus costs". Many of these agreements do not even define what costs are, or their probable amount. Moreover, the client may know nothing about the probable outcome of the litigation in terms of whether it will be a "win" and if it is, how much will be involved.^{1/}

I believe that we should encourage the states to enact rules that will provide this type of detailed information to clients. Moreover, I think they should have the opportunity of learning what their lawyer did to earn that fee. The same information that lawyers readily supply to defense clients. Finally, in cases where the award is above \$50,000, it is important to have the court review the fee for fairness. I would be pleased

^{1/} If the client knew all these facts, he might choose to pay his lawyer on an hourly basis. In spite of the fact that the organized plaintiff's bar has continued to suggest that the only thing the claimants want is a contingency fee, that data where those assertions are based on a situation where we do not have a fully informed clientele. If a client knew that his likelihood of recovery was almost certain and the minimum amount of damages he would recover would be likely to be \$200,000 and the client was a factory worker who earned \$15 or \$16 an hour, he might well choose an hourly rate.

to provide you with supplementary materials to support these suggestions.

The Collateral Source Rule.

The collateral source rule is a mystery to most laymen because of the technical nature of its name. Our casebook definition reflects descriptions found in other major tort treatises: the rule indicates that a defendant cannot benefit from the fact that a claimant has already been paid by another, "collateral" source. The basis of the rule is that a wrongdoer is not supposed to benefit from the fact that the plaintiff, through his own providence, has obtained other compensation for his injury.

If one goes to the reason for the rule, one thing is crystal clear -- the collateral source rule should never apply where the defendant is held subject to liability on a basis other than pure fault. Every treatise in the law of torts suggests that fault is the gravamen of this rule -- a wrongdoer is simply not supposed to reap unwarranted benefit. We can do a great deal to reform this area if the collateral source rule were totally abolished in absence of a plaintiff showing that the defendant was a negligent wrongdoer. ^{2/}

Partial or total abolition of the collateral source rule can be a major reform. The statistical abstract of the United States shows that close to 90 percent of Americans have some form of health insurance. A major reason for the current crisis is the unwarranted assumption on the part of some courts that they are dealing with "uncompensated" victims. Data suggests that compensation is being provided for many harms: what these courts are doing is duplicating payment. In times when economic efficiency is a matter of necessity, this is simply bad public policy.

^{2/} If the plaintiff shows that the defendant was a wrongdoer, it would be appropriate to modify the rule where the collateral source was not one obtained through the plaintiff's own providence, i.e., the purchase of health insurance, the purchase of life insurance. For example, when the benefit is one that comes from general tax revenue, government subsidy or welfare programs, such benefits should never be within the compass of the reason for the rule. See Uniform Product Liability Act, §119 (1979).

Damages for Pain and Suffering.

Similar to the collateral source rule, damages for pain and suffering had its historical origins rooted in the fact that the defendant had committed a wrongful act. Nevertheless, the damages have been maintained under modern theories of strict liability. Of equal importance is the fact that innovative plaintiffs' lawyers have changed the nature of these damages and have created an assumption that they are, indeed, compensatory. This has helped form the basis of their argument that there is an "entitlement" to such damages.

On the other hand, the little study that has been done on the matter suggests that damages for pain and suffering do not really compensate for anything. If a person has lost a hand or an eye, he does not necessarily "feel better" because he has an extra pot of money. What awards of these damages have actually done is to add a lottery element to the tort system. Again, the jury verdict research reports, which I referred to earlier, shows enormous swings in damages in this area with regard to precisely the same injury. Putting a reasonable cap on damages of this type will help bring about predictability in the system and will prevent large windfall recoveries by some claimants. This reform is likely to be stridently resisted by the plaintiff's bar. One must remember that they will be receiving approximately 35-40 percent of every dollar in pain and suffering awards. Nevertheless, it is vital to remember that this is money awarded above the person's actual out-of-pocket losses. These damages are speculative and there is no proof that they have any "healing" value whatsoever.

The Calculus.

Some law professors have theorized that what is really going on in tort law damage rules is an unstated calculus. The collateral source rule which brings a windfall and the damages for pain and suffering which can bring a super windfall are included in an award to make up for the plaintiff's attorney's fees. In that regard, unlike England, we do not award attorney's fees to the "winner" of the case. The plaintiff must pay his attorney out of his award. If his award were limited strictly

to out-of-pocket losses, he would not ultimately receive full compensation for all of his injuries. The problem with "the calculus" is that it is hypothetical in nature and not necessarily based on reality. The windfall can be far greater than any reasonable attorneys' fees.

If legislation restricts damages to out-of-pocket losses, it may be appropriate to provide some award for attorneys' fees. Again, this is something to consider if damage rules become truly compensatory in nature.

Joint and Several Liability.

American rules of joint and several liability are among the hardest to explain to educated persons who are not lawyers or who do not live in this country. In effect, these rules can take a person who is one or two percent at fault and imposes on him with the entire cost of an accident. At one point in time in our history, rules on joint and several liability fit in with the tort system as a whole. At that time our courts refused to apportion responsibility. For example, if a plaintiff were even slightly at fault, he would lose his entire claim -- that was the contributory negligence defense. Nevertheless, in 43 states, the contributory negligence defense has been abolished and the old reluctance to avoid apportionment has gone by the wayside. Thus, today, courts can and do apportion responsibility. Why have the courts made joint and several liability even harsher than it was before? For example, in the past the joint liability rules did not apply unless the defendant had "substantially contributed" to an accident through his active negligence. Now the courts impose joint and strict liability on a defendant who is not negligent at all and make that defendant pay, even though another negligent defendant is far more responsible for the claimant's harm. Courts should not impose liability on a defendant beyond the percentage of its fault or responsibility for a harm. The only exception to this rule should be when two or more defendants have acted in a wrongful concert of action. Any other approach is rife with unfairness and merely encourages a scavenger hunt for "the deep pocket".

Punitive Damages.

Punitive damages, pure and simple, were put into the law to punish persons who engaged in highly egregious social conduct. Under the common law, they were instituted to keep the peace. At the time the sheriffs were so engaged in combatting heinous crimes such as murder and arson that they did not have time for handling batteries and minor assaults. Punitive damages were put in the law to complement the criminal justice system.

It has long been suggested that punitive damages are an arbitrary windfall to injured claimants and that these damages should go to the government itself. If one is to pursue that route, one might create a conflict of interest between the needs of the state and the needs of the individual claimant, *i.e.*, should a punitive damage case be settled for net economic loss -- the state by which to "go for" the punitive damages. One approach that is of some use is to provide the claimant with some percentage of the punitive damages with the remainder going to the government or an appropriately listed charity. In any case it is vital that the damages be on some reasonable relationship to the out-of-pocket damages that are awarded.

Punitive damages may not awarded in a significant number of cases, nevertheless, they are a problem. Although punitive damages may not often be actually awarded, they are sought very frequently. They are used as an unfair negotiating tactic and delay fair and just settlements. They are used as a "bargaining chip" to settle cases because plaintiffs know that if the issue is litigated, evidence that is totally irrelevant to innocence of guilt may be admitted, *i.e.*, evidence of the wealth of the defendant, and this will influence the amount of compensatory damages awarded by the injury. Senator Danforth and Senator Kasten have begun efforts to provide reasonable reform on punitive damages in the area of product liability. Their approach and the approach you have taken deserve very careful attention.

Conclusion.

Although the organized plaintiff's bar and, unfortunately some consumer groups who have been caught in its embrace, may suggest that the legal system is working perfectly, it is not. Cases take far too long and precious resources are being wasted in trying and settling them. This system does not benefit the victim and it does not benefit defendants -- the principal beneficiaries of our current system is the organized bar. The fact that claimants' attorneys have been able to bond themselves with some consumer groups is, indeed, tragic. The interest of the average person who must pay these costs and deal with this system is forgotten. But I am hopeful that the approach you have taken, which is not to deprive victims of adequate compensation, but to facilitate the operation of the system and make it more responsive to all people's needs might receive support from all segments of our society.

It is of great benefit to the hundreds of thousands of people who have to turn to our court system that you are looking at this subject. Courts look backward at precedent and narrowly at the facts of the cases before them. They give insufficient attention to the consequences of their decisions on the shape and direction of tort law as a whole. They do not consider the impact on medical practices, transportation, manufacturing, the cost and availability of insurance and other social and economic factors. That is why the hearings by the Judiciary Committee are important and valuable -- you can focus debate on whether the tort system is working well to provide justice and, if not, how it can be changed to do so.

As you probably can tell, I both enjoy and respect the intricacies of tort law and its policies -- it has been my life's work. I would be pleased to work with you to help make tort law and its processes more equitable for all persons.

Senator McCONNELL. Thank you very much, Mr. Schwartz. I have got a whole series of questions here I am going to submit, but I want to ask you a couple of them and then we will all get out of here for lunch.

You have in the past suggested that it is possible for the States, either through case law or statute, to address the product liability problem in a meaningful way. Would you explain how you came to that?

Mr. SCHWARTZ. When I was chairing the Federal interagency task force, we felt that if we were making a big leap to change tort law from being decided on a case-by-case basis into statutes, and we drafted a statute called the Uniform Product Liability Act. It was our thought that we should attempt to see whether the States would adopt a model code on a State-by-State basis to see if that would work before Federal action was tired.

We attempted it and the net result was 32 States passed some form of law and each one was different. It was almost the way people go through a supermarket and take a little of this and take a little of that. So instead of more uniformity, unfortunately we had less in an area dealing with interstate commerce, so then we shifted to the idea of having a Federal uniform statute in an area that is rife with interstate commerce.

Senator McCONNELL. Well, thank you very much. I especially enjoyed your testimony and I am sorry for the delay and I will submit additional questions for you, if you do not mind that.

Mr. SCHWARTZ. No; that would be appreciated and I value the fact that you have an interest in what I have to say. Thank you very much Senator.

Senator McCONNELL. Thank you very much. The hearing is concluded.

Thank you.

[Whereupon, at 12:33 p.m., the committee adjourned.]

LITIGATION ABUSE REFORM ACT OF 1986

WEDNESDAY, MARCH 26, 1986

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 9:34 a.m., in room SD-226, Dirksen Senate Office Building, Senator Mitch McConnell presiding.

Also present: Senators Simon and Specter.

Staff present: Victor Maddox, counsel; and Christopher S. Dunn, minority counsel.

OPENING STATEMENT OF SENATOR MITCH McCONNELL

Senator McCONNELL. The hearing will come to order.

I thank all of you for coming out this morning. I have an opening statement. The subject of the hearing today is the Litigation Abuse Reform Act of 1986, S. 2046. I want to particularly thank at the outset Chairman Thurmond for his interest in this subject and for his willingness to call this hearing at my request on the growing crisis in our civil justice system.

It is a liability crisis, an insurance crisis, and a crisis of confidence in our court system. It is a crisis that reaches all Americans, from the homeowner to the working mother, to the owner of a small business, and to the largest corporation.

The bill I have introduced, S. 2046, helps chart a course back to a sensible balance between free and unfettered resort to the courts and recognition of the need for a more pragmatic, responsible approach for dealing with civil disputes.

Hardly a day goes by that we do not hear or read of the dramatic increase in the number of lawsuits filed, of the rates charged by insurance companies, in part because of the latest multimillion-dollar verdict, or of another small business, child care center, or municipal corporation that has had its insurance canceled out from under it. Those businesses and corporations that are able to retain their insurance are often met with increases in premium costs of 100, 200 percent, or more.

Why are insurance rates increasing so dramatically? Why are the courthouses so crowded, despite the addition of over 100 Federal judges in the last 8 years? Because, quite simply, everyone is suing everyone, and most are getting big money. I know of the one case in Louisville, in which the parents of a young girl allowed her to help her uncle cut heavy-duty reinforcing wire for concrete construction. The wire had been rolled into a coil for shipment, and would naturally recoil when rolled out and released. Yet the uncle

let this 9-year-old girl hold down the wire while he cut it, and while he looked away, the construction wire sprang back and struck the girl.

The parents, who were fully aware of what the girl was doing, nevertheless sued the manufacturer for \$750,000 for failing to warn the 9-year-old girl of the danger. The jury in that case returned a verdict of zero against the company. Yet, despite an offer of settlement by the defendant, the case dragged on for 2 years, ending with a 3-day trial, and the legal fees were tens of thousands of dollars.

Nor is this an isolated incident. There are dozens of examples like this, examples in which the system can hardly be said to have served us well. In many cases, it clearly led to an inexplicable result.

Without a doubt, our present civil justice system promotes litigation, almost for litigation's sake. What is most disturbing about this state of affairs is that so little good comes from so much litigation. Indeed, this crisis will most likely reserve its harshest consequences for American consumers. When obstetricians withdraw from their profession, the quality of health care for all of us suffers. When drug manufacturers remove a product from the market, those most vulnerable are denied their only means of help.

I recently received a number of letters from citizens all over the country, and they illustrate the problem we are here to deal with today. Dr. Joseph Rush, of St. Petersburg, FL, wrote that his son had been the victim of the civil justice system. After sustaining serious injuries as the result of a motorcycle accident, and incurring \$55,000 in medical expenses, Dr. Rush's son collected \$78,000 in a lawsuit. But of that, \$38,000 went to his attorney, and the young Mr. Rush was left with only \$40,000, far less than his actual expenses.

John Marshall, of Sumter, SC, wrote that because of the insurance crisis, the neighborhood swim center had been forced to announce that it would close as of February 28, 1986. As Mr. Marshall put it, "Those who are suffering the loss of this well-run indoor swimming pool are elderly arthritis victims who use the pool for therapy, young children learning how to swim * * *, swim teams learning to compete, and just plain folks who are trying to keep fit."

Finally, John Martin, of Louisville, wrote to relate another aspect of the problem. In a case in which two passengers in a county highway maintenance vehicle were injured, their total medical bills were \$4,000. At the trial, the jury deliberated some 25 minutes, and awarded each plaintiff a quarter of a million dollars in "pain and suffering." The total cost to the defendant, \$604,000.

I even received a letter from the president of the Kentucky Bar Association advising me of a proposal to create a captive self-insurance pool for lawyers in Kentucky and neighboring States. The letter began by noting, ironically, that the situation with malpractice insurance for attorneys had reached crisis proportions.

I am going to include the full text of those letters in the record at this point.

[The letters referred to follow:]

Joseph C. Rush, M. D.

Radiologist

666 Tyrone Blvd

St. Petersburg, Florida 33710

February 25, 1986

Telephone 347-6119

Senator Mitch McConnell
Republican, Kentucky
Senate Office Bldg.
Washington, D.C.

Dear Senator McConnell,

I see in the newspapers an article through the Associated Press on the unreasonable and outrageous system we have for settling damage suits. Having been sued for malpractice, and having successfully defended myself, I believe that the system is indeed outrageous. We need three or four things in the court system to tone things down a bit, so as not to protect the guilty party in a damage suit, but to see that most of the award goes to the damaged party rather than to the legal system and the plaintiff's attorneys. Specifically in the field of medical malpractice, which might be adopted to other forms of damage suits, we need:

1. A cap on attorney contingency fees, much the same as the State of California now has, which has been found to be constitutional by the U.S. Supreme Court. This reduces gradually the contingency fees so that after you get past two hundred thousand dollars (\$200,000), the attorney gets only ten percent. The most recent legislation in Florida reduces the contingency fee to fifteen percent for the attorney after you get by two million dollars.
2. We need a cap on pain and suffering of roughly one hundred thousand dollars (\$100,000) except in extraordinary cases. It is very hard to measure pain and suffering, but the attorney should not get forty percent of whatever agony the patient went through.
3. We need a system that allows the claimant to go to the court house for twenty five dollars and file a notice of intent to sue so that the claimant might deal directly with the defendant without any contingency fee, whatsoever, or with a very minimal contingency fee of possibly two percent. This system might allow sixty days or ninety days for the two parties to get together supervised by the court. The claimant eventually needs some legal advice so that he doesn't sign away his right unnecessarily. The attorney's worth in the system, however is very small, and the attorney should not receive a large percentage of this award.

I have further experience in the matters. I had a twenty-one year old son, who hit a stalled truck on the roadway in Mississippi on his motorbike. He has a paralyzed shoulder, and we have medical bills through our insurance provider for roughly fifty-five thousand dollars (\$55,000). Since his shoulder is

Joseph C. Rush, M. D.

Radiology
666 Tyrone Blvd.
St. Petersburg, Florida 33710

Telephone 347-6119

paralyzed his sports career is over in football. He is deformed and his earning capacity is very restricted. He collected roughly seventy-eight thousand (\$78,000) in a lawsuit, but the attorneys got thirty-eight thousand dollars (\$38,000) of this, and he ended up with forty thousand and fifty-seven dollars (\$40,057).

The medical care which he received being brought in in a state of shock by a helicopter with a torn kidney, paralyzed shoulder, multiple broken bones, punctured and contused lung, and foot half torn off, was such that he was lucky to survive. I wonder, however, why the legal system, particularly the plaintiff's attorney should have a fee almost as great as that of the hospital, surgical, and medical bills combined. If there is any justice in this system, I would like to have you explain it to me.

I would be delighted to appear before your committee at any time that would be relatively convenient for both of us to say my piece. It would not take three minutes for me to do so, and to give you the views of the Florida Radiological Society, and how we might justifiably change the system, so that more of the insurance dollar ended up in the injured parties pocket.

Best regards.

Sincerely,



Joseph C. Rush, M.D.
Radiologist

JCR;se

cc: Robert Williams, M.D.
Florida Radiological Society
Watson Clinic
Lakeland, Fl 33802

Colby Cowherd, M.D.
Radiology Department
Baptist Hospital
1740 South Limestone
Lexington, Kentucky 40503

Gamecock City Broadcasting, Inc.

P. O. Drawer 38
Sumter, South Carolina 29151

February 24, 1986

Senator Mitch McConnell
United States Senate
Washington, DC 20554

Re: Liability Insurance Costs

Dear Senator McConnell:

I read a newspaper article about your efforts to limit damage awards. I am enclosing a letter I received just last week. Our neighborhood swimming center in Columbia has been forced to shut its doors because its insurer refuses to renew its liability policy and the only company willing to write the policy charges TEN TIMES the previous premium.

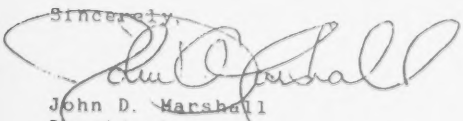
Some of those who are suffering the loss of this well run indoor swimming pool are an elderly arthritis victim who uses the pool for therapy, young children learning how to swim, parents learning how to swim so they can join their children, swim teams learning to compete, and just plain folks who are trying to keep fit.

I, myself, belong to the last category. I lost 40 pounds by swimming regularly at The Aquatic Center and I feel healthier than I have in 15 years. Because of a bad back I cannot maintain my fitness by jogging. I, like the other members of the center have no place else to go (the local YMCA pool is too small for lap swimming). The only other olympic size indoor pools in Columbia belong to Fort Jackson and the University of South Carolina and I am neither a soldier nor a student.

I appreciate your efforts to limit damage awards. Jurors think that the defendants in lawsuits pay punitive damages. They, of course, don't. We ALL do through insurance premiums. And because of the effects of skyrocketing premiums, the members of the Aquatic Center are paying with the loss of their fitness.

I am an elected delegate to the National White House Conference on Small Business and this problem is one of our major concerns. Please send me a copy of your proposed legislation.

Sincerely,


John D. Marshall
President



The AQUATIC CENTER, Inc.

An Indoor Community Aquatic Facility

February 15, 1986

Mr. John Marshall
10 Gardenwood Court
Columbia, SC 29209

Dear Mr. Marshall:

As you know, the Aquatic Center is a membership based swim facility as well as a pool and spa contractor. We are very sorry that we have to bring you the following information.

At the close of business on February 28, 1986, the swim facility portion of the Aquatic Center will close permanently. There will be no further access to the pool, hot tub, saunas, and isokinetic lab.

The closing of the swim facility is against our wishes and it is important to us that you understand why it is closing.

We have been carrying, as per industry standards, a \$500,000 liability insurance policy. We have a spotless record with the insurance company, however, they have elected not to renew our policy this year. They say that this is due to claims filed by other businesses in other states within the industry, and also due in part to the state of affairs in the insurance industry within South Carolina. We have searched diligently for another carrier, but to no avail. We were able to find one carrier that agreed to a \$100,000 policy at twice the premium we are paying for \$500,000, and another that agreed to a \$500,000 policy at a premium ten times higher than we are presently paying.

The required liability insurance for this facility is \$500,000. We cannot meet the increased insurance premium unless we double the cost of memberships, and this we will not do. The Aquatic Center was started on the theme of affordable family aquatic activities, and we will not deviate from this.

As you know, we have worked long and hard in making this facility a safe, clean, family fun center. We have appreciated your patronage and have become very close to most of you.

Our records indicate that your membership began in June of 1985. We do not want anyone else to be burdened with the problems created by the insurance company; consequently, we are prorating the membership dues we have collected from you, based on twelve months. We have deducted the months used and will send you a check in the amount of \$37.50 during the month of March, 1986.

It is with great regret that we have written this letter. The Aquatic Center will continue to operate and expand as a pool and spa contractor. We have always carried a full line of pool supplies, and will continue to do so.

It is our hope that at some time in the future we will be able to reopen the swim facility aspect of The Aquatic Center.

Sincerely,

Judi A. Bass

Judi A. Bass
President/Owner

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March 10, 1986

Honorable Mitch McConnell
United States Senator
For the Commonwealth of Kentucky
Senate Office Building
Washington, D.C. 20510

Re: Litigation Reform Act of 1986

Dear Senator McConnell:

I have recently been made aware of your sponsorship of the Litigation Reform Act of 1986, which appears to be a commendable effort to bring order to the chaos of federal litigation. My understanding is that the Act places limitations on punitive damage awards and other areas of recovery, for actions brought in the federal court system. This is certainly long overdue.

As you may be aware, my law firm does a considerable amount of work in the insurance defense field, representing the interests of insurance companies and their insureds in Lexington and Eastern Kentucky. I was recently involved in a trial in Breathitt County, Kentucky, and the insurance carrier involved, Empire Fire & Marine Insurance Company, thought that it might be worthwhile to bring this case to your attention as a glaring example of what is wrong with our court system. Two Breathitt County officials, a county road supervisor and a county magistrate, James Boyd Noble and Hubert Hollon, respectively, were injured when their vehicle was struck from behind while on Kentucky 15 by a fully loaded coal truck driven by my client, Alfred Estes, while employed by the truck's owner, Gary Miller. Mr. Hollon sustained a whiplash injury, and incurred slightly over \$1,300.00 in medical bills. He missed approximately one week of work, but claimed continuing difficulties to his neck and upper back.

Honorable Mitch McConnell
March 10, 1986
Page Two

LANDRUM, SHOUSE & PATTERSON

Mr. Noble sustained a broken nose in the collision, and incurred medical bills which totaled slightly over \$2,700.00, which were paid by his workers' compensation carrier. In addition, he was paid by his compensation carrier for approximately eight weeks of work which he missed.

The case was tried in Breathitt County on February 20, 1986. The medical bills were placed in evidence, at the totals which I have indicated. The jury was out for approximately 25 minutes, and returned with a unanimous verdict in favor of the plaintiffs. The jury awarded each plaintiff \$50,000.00 in future medicals, and further awarded each plaintiff \$250,000.00 in past and future pain and suffering. In addition, the medical bills proven were awarded to the plaintiffs. The total verdict was in excess of \$604,000.00.

I certainly agree with my client that the verdict is out of all proportion to the severity of the injuries claimed, or the damages proved. It probably reflects the fact that the plaintiffs were elected officials in Breathitt County, while my clients both resided in another county. While this situation is not one which could necessarily be corrected by your proposed legislation, it is certainly an example of the disparity in our civil trial system.

I wish you continued success in your effort on litigation reform.

Very truly yours,



JOHN R. MARTIN, JR.

JRMjr/fr

cc: Honorable Mitch McConnell
United States Senator
600 Federal Place
Louisville, Kentucky 40202

KENTUCKY BAR ASSOCIATION

W. MAIN AT KENTUCKY RIVER

FRANKFORT, KENTUCKY 40601

(502) 564-3705

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Dear Fellow Member of the Bar:

All of you are aware that a crisis exists in the legal malpractice insurance industry. Many of the law firms in Kentucky have faced malpractice premium increases of up to 500 percent during this past year and all indications are that the increases will continue during the next twelve months. The rapidly escalating premiums, along with the restrictions in policy coverage and the limited market for new business, is of great concern to your Association.

The Legal Malpractice Insurance Committee of the Bar under the Chairmanship of Board of Governors Member Joe B. Campbell of Bowling Green, has studied the options available to the Bar in an effort to bring an end to this crisis. The best option at the present time appears to be the creation of a lawyer owned malpractice insurance company. In order to determine the feasibility of such a company, your Bar leadership has voted to survey the membership. Enclosed is a survey that I am personally asking each member of the Bar to take a few minutes to review, complete and return to the Kentucky Bar Association. We have engaged a consultant to conduct this feasibility study, and our consultant has already worked with five other state bar associations in establishing bar related lawyers professional liability insurance companies.

Preliminary studies have shown that capitalization of \$2,500,000 will be necessary in order to establish a viable and financially sound company. This means that at least 2,500 members of the Bar must be willing to contribute \$1,000 each for capitalization. Obviously, this is a large segment of the Kentucky Bar Association which currently has a total membership of 9,000.

-2-

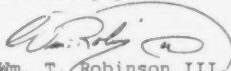
It should be noted that the "goal" of a "captive" malpractice insurance company is to stabilize premiums over the long term, and that an investment in such a company may not realize profits for the investors for several years. We believe, however, that the feasibility of this project must be studied; and that the leadership of the Bar has the responsibility of exploring every option to make every effort to bring an end to this crisis. Chief Justice Stephens of the Kentucky Supreme Court has graciously issued a memorandum, a copy of which is enclosed, requesting that all members of the Kentucky Bar cooperate in this important endeavor.

The importance of this survey is underscored by the fact that the claims experience of Kentucky lawyers is much more favorable than the claims experience of lawyers in other jurisdictions. However, when premiums are established by the insurance industry, the claims experience of all lawyers is considered. As an example, one of the companies currently writing malpractice insurance coverage in Kentucky paid out over \$130 for every \$100 received in premiums last year on a national basis, but paid out only \$75 per \$100 received in Kentucky.

I urge you to take this opportunity to participate in the determination of the feasibility of a lawyer owned malpractice insurance company.

Thank you for your time and effort.

Sincerely yours,



Wm. T. Robinson III, President
Kentucky Bar Association

Enclosures

Senator McCONNELL. These are the kinds of problems S. 2046 seeks to come to grips with. The simple fact is we have let the civil justice system proceed on its own course with almost no direction, either at the State or Federal level. Aside from the medical malpractice field, there has been little policy directive from the legislative branch of Government. The judiciary has been free to set its own course, guided principally by activist judges and a legal profession with a vested interest in broader tort rulings. Many, if not most, Americans have come to realize that that course is in serious need of adjustment.

S. 2046 seeks to impose rational restrictions on the award of damages in Federal courts, and to impart a significant degree of predictability to the potential liability a defendant faces. It does this by putting a cap of \$100,000 on the award of noneconomic damages, or "pain and suffering" awards. These are awards that are inherently unpredictable, and limited only by the whim of the jury. Importantly, this limitation will not—I repeat, will not—deprive any injured party of the first nickel in actual, economic damages, such as past or future medical expenses, or loss of earnings.

In addition, S. 2046 would require periodic payment of awards of damages greater than \$100,000 on a schedule approved by the court. It would eliminate the collateral source rule, requiring that damage awards be reduced by the amount of any other payment, such as insurance or workers' compensation, that a plaintiff has received as a result of his or her injury.

These benefits, on top of the award to actual damages, are a windfall to the plaintiff. Though it may once have been important to exclude such benefits from the computation in order to deter negligent conduct, that time has long since passed.

Finally, my bill will clarify the standard to be used for the award of punitive damages, and provide that such awards are to be paid to the court. Punitive damages were never intended to compensate the plaintiff, and their punitive effect will be just as great if paid to the court, while removing the incentive for lawyers to pursue large punitive awards.

Let me also point out that the bill has two other major provisions. One will limit the amount of contingency fees that an attorney may obtain in a case, based on the amount of the recovery. There is no point in watching an evergrowing portion of the awards in tort cases go to the lawyers, many of whom have become fabulously wealthy, part of what the ABA trumpeted on the cover of its journal last month as part of the new elite plaintiffs' bar.

The other provision would clarify the standards for holding lawyers who initiate any civil action without a goodfaith belief in the substance of them liable for costs, including attorney fees. It would also create a new sanction against lawyers who initiate any civil action without a reasonable belief that there is a good ground for recovery of the relief requested, or merely to force a monetary settlement. This is perhaps the most egregious abuse of the civil justice system, and the bill would hold such attorneys responsible for treble costs, including the attorney fees necessary to resist the action.

I was pleased to see that the Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Cur-

rent Crisis in Insurance Availability and Affordability—only a bureaucrat could have made up a title like that—issued last Thursday by the Department of Justice, endorses a number of proposals set forth in my bill. Indeed, in some respects the recommendations of the Working Group go beyond the reforms proposed here. I will be looking forward to working with the administration on this issue, in an effort to turn the recommendations of the Working Group into effective policy reform.

Let me also point out that no segment of our society is blameless in connection with the crisis we now face. That is certainly the case with the insurance industry. A number of suggestions have been made that the industry is in fact chiefly responsible for the crisis.

The Lexington Herald-Leader in my home State recently suggested that "through massive rate increases affecting all types of insurance and cancellation of many forms of liability coverage, the industry has created a climate of hysteria among consumers."

I am going to include at this point in the record that Lexington Herald-Leader editorial of Sunday, March 9 of this year.

[The editorial referred to follows:]

Yes, insurance crisis exists, but examine its causes

Across the nation, insurance companies are engaged in a campaign to change liability laws to their advantage. The success of this effort is evident in the Kentucky General Assembly, where the industry is lobbying for limits on some liability damages and elimination of others, and in the halls of Congress, where Kentucky Republican Sen. Mitch McConnell has introduced one of several bills that would change federal tort law.

These changes are proposed in response to a real crisis. But there is considerable evidence that the industry has created much (although certainly not all) of the crisis and that it is using scare tactics to win a legislative response favorable to its own interests.

Through massive rate increases affecting all types of insurance and cancellation of many forms of liability coverage, the industry has created a climate of hysteria among consumers. Doctors, municipal governments, bar owners, ministers, chemical companies, churches, the Girl Scouts and even insurance agents themselves find their bills skyrocketing and their coverage shrinking.

In this climate of hysteria, legislators are rushing to do the things the insurance industry says are necessary to solve the crisis. Before coming to the aid of the companies, though, lawmakers should look at the insurance industry's own contributions to this crisis.

To begin with, they might think back to the medical malpractice "crisis" of the 1970s. After the industry used that "crisis" to get some of the legislative changes it wanted, a study by the federal government concluded that there had been no real crisis.

There is a similar gap between reality and the industry's current rhetoric of crisis. The industry is crying about its operating losses, but it made a net profit of more than \$1 billion last year. Its net worth rose by \$7.6 billion in the same year. Its stocks were among the biggest gainers on Wall Street last year, increasing in value by about 50 percent — twice the average

increase of all stocks. That is hardly the mark of a failing industry.

Yes, the insurance industry suffered operating losses, in terms of paying out more in claims than it took in from premiums. But profits from investments more than offset those losses. And in any event, the operating losses are largely due to the industry's own mistakes.

Back in the 1970s, when interest rates were hovering around 20 percent, the usually staid insurance industry went a bit berserk. Companies engaged in price wars, slashing premiums to beat the other guy. They wrote ridiculous policies involving extremely high risks. Why were companies engaging in such stupid business practices? They were after as many dollars in premiums as they could get so they could invest the money in no-risk, high-return securities.

(A case in point: One company actually wrote a policy covering the MGM Grand Hotel fire months after the fire had occurred. Why? Presumably, the company expected to profit from investments during the years it would take for damage claims to wind their way through the courts.)

The industry, of course, says it is not to blame. When insurance companies raise premiums and cancel coverage, they blame it on a "tort crisis." But is there really a tort crisis?

To be sure, there have been some absurd damage awards made by juries, and the insurance industry will tell you all about them. For instance, there was the case of the man burned when his Ford Pinto exploded. The jury awarded the man \$128 million in damages. In this case as in many others, though, the absurd jury decision was reduced on appeal. The man in the Pinto got \$6.8 million after appeal. That's still a lot of money, but it's also one case out of thousands. The big multimillion-dollar damage awards are still the exception, rather than the rule. Adjusted for inflation, the median jury verdict has remained fairly constant for more than 25 years.

But aren't there more lawsuits being filed today? In total number, yes. But the number of lawsuits per capita has also remained constant for that same quarter of a century.

Even when the industry gets what it wants, there is no relief for consumers. Pennsylvania has the strictest limits on damages of any state in the country, but there is still a medical malpractice "crisis" in that state, according to the industry. And as far as municipal liability is concerned, Schuylkill Township in Pennsylvania was subject to a 1,037 percent increase in rates in 1985. (Of course, that increase is small potatoes in comparison to the 4,700 percent rate increase being imposed on the Southern California Rapid Transit District, which, by the way, didn't have a single accident last year.)

According to the Coalition for Consumer Justice, virtually every change in tort law the industry wants is in effect in Ontario, Canada. Rates there are going up by 400 percent and the industry is still refusing to provide coverage for some day care centers, schools and cities.

Not that legal reforms aren't needed. They are. Some restrictions on the growing tendency to hold third parties liable — as in the case of bartenders and party hosts when a drunken driver has an accident — are in order. The contingency fees of lawyers handling liability suits could be made subject to a sliding scale linked to the size of the award. State and federal laws should be changed to allow for the recovery of legal fees spent defending against costly "nuisance" suits.

These reforms would deny legal rights to no one. The same can't be said for the industry's so-called reform proposals, which constitute a denial of rights Americans have always enjoyed.

Given the importance of insurance and the growing concentration of the industry, more rather than less regulation seems in order. A useful place to start might be to end the industry's exemption from anti-trust laws.

At the least, though, lawmakers should stop their headlong rush toward granting the insurance industry all that it seeks. If the industry has its way, Americans will lose many of their traditional rights to redress for injuries. That's not a decision to be made in a climate of crisis and hysteria.

Senator McCONNELL. Some, including the newspaper that I just mentioned, have suggested that the trends in jury verdicts and in the amount of litigation is not out of line with expected increases due to inflation and population gains. In short, they argue that there is no crisis. But the fact is that the number of civil cases filed in Federal court has increased over 100 percent in just 10 years, far more than the population.

Similar, if not worse, increases have been experienced in State courts. The average size of verdicts has likewise risen dramatically, with increases of 15.36 percent in 1984, 27.5 percent in 1983. These increases are far greater than the general level of price increases. Something is responsible for this pattern, and we need to get to the bottom of it.

That is the subject, of course, of the hearing today.

I have just been handed a note. I wanted to mention that the chairman, Senator Thurmond, has been delayed and hopes to come by later during the course of the hearing. We look forward to having him here.

Our first witness today, the chairman of the Working Group of the administration, is the Honorable Richard K. Willard, who is the Assistant Attorney General for the Civil Division.

I would like to point out that we have a fairly lengthy hearing today. If any of us goes too far—and I would very much like to encourage all of the witnesses to limit their statements to about 5 minutes, we will insert the full statement in the record, but it would be very helpful to all of us to have a summary.

Mr. Willard.

STATEMENT OF RICHARD K. WILLARD, ASSISTANT ATTORNEY GENERAL, CIVIL DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. WILLARD. Thank you, Senator. It is a pleasure to be here today to appear before this committee to discuss the liability insurance crisis and the need for meaningful reforms of our civil justice system.

As the administration official who chaired the Working Group that produced the administration's report which has been furnished to the committee, I particularly appreciate having the opportunity to appear here and answer any questions that either you or other members of the committee may have about the material in the report.

My prepared testimony, which I understand will be inserted in the record, is fairly brief because the issues are much more comprehensively discussed in the report that we provided.

We appreciate in particular, Senator McConnell, the legislation that you proposed to deal with this effort. And while the administration is continuing to study S. 2046, we do believe that many of its provisions propose constructive answers to the current problems we are facing.

In my testimony last summer before this committee on S. 1254, Senator Grassley's contractor indemnification bill, I identified two clear reasons why Government contractors and other commercial manufacturers were alarmed about product liability and commercial risk exposure. These reasons are the innovative theories of tort

liability applied by many courts and, second, the enormous growth in the size of awards being granted by many juries and courts.

These troubling trends in the tort system are not confined to Government contractors or to product liability cases, but have generated uncertainty and instability in almost every facet of the liability insurance marketplace and have contributed significantly to the current liability crisis.

While everyone agrees that the high cost or unavailability of liability insurance is a major crisis facing American society, not everyone agrees on the cause of the problem.

Some groups have been before Congress—notably the National Insurance Consumer Organization and the trial lawyers—to suggest that the current crisis stems from the insurance industry's own greed and shortsighted underwriting policies. They would assert that the current price increases are simply insurance industry efforts to recoup past losses suffered as a result of industry mismanagement.

Others contend that the problem is cyclical and will disappear when low interest rates rise. Still others agree with Ralph Nader, who has testified before Senate and House committees that the entire crisis or problem is a hoax, a conspiracy by the insurance industry to use legislatures to further defraud the insurance consumer.

I would like to start by saying—and our report discusses at greater length—that the history of the insurance industry has been cyclical. And it is true that some of the current increase in liability insurance costs are the result of past competition for premium income as well as the sharp decline in interest rates. However, while it seems likely that these cyclical problems will be mitigated to some extent with the passage of time, it is very unclear whether these developments or regulatory changes can alleviate the underlying long-term problem caused by the expansion of liability in our civil justice system. Thus, we believe that the insurance availability problem is one symptom of an underlying dislocation caused by a malfunctioning tort system and what is called for is a cure for the disease, not simply treatment of the symptom.

In my prepared statement I outline and in the report we further detail what we regard are four specific developments in tort law that deserve attention.

The first is the movement toward no-fault liability, not as a result of no-fault legislation, but as a result of judicial decisionmaking, overturning traditional tort law doctrine that formerly required some showing of fault as a basis for recovery. Instead courts are adopting a sort of risk-shifting and social insurance theories in which defendants can be held liable without a showing of fault.

The second trend is an undermining of the causation requirements or the approximate cause requirement that traditionally is required in tort law. Through doctrines such as joint and several liability "deep pocket" defendants who may be only slightly at fault for an accident, but who can be required to pay all of the damages if the parties at fault are not available or do not have enough money.

The third development that I mention in my prepared statement is the explosive growth in noneconomic and punitive damages.

The last finding made in the report is that the transaction costs of the tort system have become excessive and overburdensome. In particular, the Rand Corp. study of the asbestos litigation showed that an average of 63 cents of every dollar paid out by the companies and their insurers went to count costs, plaintiffs' lawyers and defense lawyers, and only about 37 cents of each dollar went to compensate victims. This is an extremely high transaction cost and raises serious questions about the fairness and efficiency of the tort system, certainly if the tort system continues to expand as it has.

These are four areas of tort law where we believe reform would be appropriate. Meaningful reform, however, will require the Federal Government to work closely with the States. In product liability law, for example, the administration has for many years supported Federal legislation which addresses the excesses of current law. In other areas, there are questions which must be carefully considered concerning how the Federal Government can appropriately promote sensible tort reform within the framework of federalism.

Senator McConnell, you and others in Congress have demonstrated a willingness to address the problem. We at the Justice Department look forward to working with this committee on appropriate legislation.

I would now be pleased to answer any questions you may have.
[The prepared statement of Mr. Willard follows:]



Department of Justice

STATEMENT

OF

RICHARD K. WILLARD
ASSISTANT ATTORNEY GENERAL
CIVIL DIVISION

Mr. Chairman and members of the Committee:

The Department of Justice appreciates the opportunity to appear before the Senate Committee on the Judiciary to discuss the liability insurance crisis and the need for meaningful reforms of our tort civil justice system. Senator McConnell and others have proposed legislation that attempts to address these difficult issues. While the Administration is continuing to study S.2046, many of its provisions propose constructive answers to our current problems.

In my June 11, 1985 testimony before this Committee on S.1254, Senator Grassley's contractor indemnification bill, I identified two clear reasons why government contractors and other commercial manufacturers were alarmed about products liability and commercial risk exposure. Those reasons are the innovative theories of tort liability applied by many courts and the enormous growth in the size of awards being granted by many juries and courts. These troubling trends in the tort system are not confined to government contractors or to products liability cases, but have generated uncertainty and instability in almost every facet of the liability insurance marketplace and have contributed significantly to the current liability crisis.

As this Committee has already heard, and other members of Congress are undoubtedly becoming aware, liability insurance premium rates have increased by up to 1000 percent, if not

more. Often, coverage is unavailable at any price, with devastating results. The liability crisis affects virtually every segment of American society -- manufacturers, professionals, small businesses, municipalities and nonprofit organizations. Many believe that tort reform and insurance availability are the most important issues facing these groups today.

The Cause of the Problem

While everyone agrees that the high cost or unavailability of liability insurance is a major crisis facing American society, not everyone agrees on the cause of the problem.

Some groups have been before Congress -- most notably the National Insurance Consumer Organization and the trial lawyers -- to suggest that the current crisis stems from the insurance industry's own greed and shortsighted underwriting policies. They would assert that the current price increases are simply insurance industry efforts to recoup past losses suffered as a result of insurance industry mismanagement.

Others contend that the problem is cyclical and will disappear when low interest rates rise. Still others agree with Ralph Nader, who has testified before Senate and House committees that the entire crisis or problem is a hoax, a conspiracy by the insurance industry to use the legislatures to further defraud the insurance consumer.

Let me start by saying that the history of the insurance industry has been cyclical. And it is also true that some of the current increases in liability insurance costs are the result of past competition for premium income as well as the recent sharp decline in interest rates. However, while it seems likely that the insurance industry will be able to work its way out of its present economic straits, it is very unclear whether more favorable market conditions and more deliberative underwriting practices will significantly alleviate the long-term insurance availability and affordability problem. Early indications are that insurers will continue to avoid areas that

present a high risk of tort liability and, in those areas where insurance is offered, uncertainty about present and future liability will continue to dictate high premiums. It is becoming apparent that the insurance availability/affordability crisis is but one symptom of the dislocations and problems generated by a malfunctioning tort system. What is called for is a cure for the disease, not a treatment for the symptom.

The Administration strongly believes that the essence of the problem is a number of tort decisions of the last few years in which courts, driven by plaintiff lawyers, have brought about a vast expansion of civil liability and an enormous increase in the size of damage awards. Our civil justice system is no longer seeking to impose liability based upon traditional doctrines of fault. Rather, the system seeks to compensate plaintiffs at the expense of those who have the resources to absorb the costs.

I would like to discuss four specific developments in tort law that deserve particular attention, and perhaps legislative redress, whether at the federal or state level.

1. The movement toward no-fault liability

As I have stated in earlier testimony before this Committee, fault has been the centerpiece of tort law since the days of the industrial revolution. It assigns liability based on the reasonableness of the actor's conduct or activity, distinguishing socially beneficial, from socially harmful, conduct. Stated differently, without basing tort law on the concept of fault, we risk punishing those who do good -- whether by cleaning up asbestos or by manufacturing a childhood vaccine. In effect, without fault, tort liability becomes nothing more than a judicially imposed insurance scheme.

2. Undermining Causation

The gradual undermining of the requirement of causation through a variety of questionable doctrines and practices, has been used to shift liability to "deep pocket" defendants even

though their actions did not contribute to the underlying injury or had only a limited or tangential affect.

While the attack on the requirement of causation cannot be attributed to any single innovation, one principal vehicle has been the expanded use of joint and several liability. The doctrine of joint and several liability allows the plaintiff to recover the full judgment from any one of several defendants, rather than collect from each one individually according to his degree of fault. The practical effect is that "deep pocket" defendants guarantee the recovery of huge judgments rendered by sympathetic juries, even in situations where they have been found only slightly at fault.

This application of the doctrine of joint and several liability is a radical departure from its originally intended application in cases where multiple defendants were in "concert of action".¹ Unfortunately, modern courts have shown an increasing willingness to apply joint and several liability as a viable means of securing a financially sound source from which to recover.

3. The explosive growth in noneconomic and punitive damages

Another identified problem area is the explosive growth in the damages awarded in tort lawsuits, particularly with regard to noneconomic awards, such as pain and suffering or punitive damages.

A recent report by Jury Verdict Research, Inc. indicates that the average medical malpractice jury verdict increased from \$220,018 in 1975 to \$1,017,716 in 1985 -- an increase of 363%. Average product liability jury verdicts during this same period increased from \$393,580 to \$1,850,452, an increase of 470%.

Interestingly, much of this increase can be attributed to a remarkable growth in verdicts above \$1 million. The same study notes that in 1975, there were three million-dollar medical malpractice verdicts and nine million-dollar product liability

¹ See generally Prosser and Keeton on Torts (5th Ed., 1984) Chapter 8.

verdicts; by 1984, the number of medical malpractice million-dollar verdicts had grown to 71 and the number of products liability million-dollar verdicts to 86. This is an increase of over 1200% in the number of such verdicts.

While it is not possible to quantify precisely how much of these awards are for noneconomic damages, it appears that noneconomic damages, such as awards for pain and suffering and punitive damages, are a substantial factor. These types of damages are inherently unconstrained and subjective, and, therefore, are subject to dramatic inflation and wide variation. That is, in two cases involving similarly injured plaintiffs; because of the existence of these types of subjective damages, there is little chance that the two will receive comparable awards. The outcome and size of a particular award or settlement is becoming based more on the defendant's perceived ability to pay rather than the extent of the injury to the plaintiff.

4. Excessive Transaction Costs

Finally, another serious problem of the tort system that should be noted is its extraordinarily high transaction costs.

It appears increasingly difficult to afford justice in this country. In fact, some would argue that the system, intended to benefit the injured and to do justice for all, only benefits the lawyers and is reserved for those who can afford it.

A study of liability cases from asbestos-related injuries by the Rand Corporation's Institute for Civil Justice indicates that out of every dollar paid out by the asbestos manufacturers and their insurers, an average of 62 cents is lost to attorneys' fees and litigation expenses.² Rand found that a

2 J. Kakalik, P. Ebener, W. Felstiner, G. Haggstrom & M. Shanley, Variations in Asbestos Litigation Compensation and Expenses xviii (1984). These costs, of course, include both plaintiffs' and defendants' litigation expenses. In comparing the costs attributable to plaintiffs' litigation expenses it is useful to remember that defendants incur such costs whether or not they prevail, and, indeed may incur substantial costs defeating even clearly frivolous claims.

typical asbestos court case results in a cost of \$380,000. Of this, \$125,000 is for legal defense fees, \$114,000 is for legal fees paid by the plaintiff. It is difficult to justify such exorbitant costs, particularly when these costs are usually borne by the seriously injured or the innocent consumer through higher prices for goods and services.

These are four major areas in tort law where reform is necessary. Meaningful tort reform, however, will require the Federal Government to work closely with the states. In products liability law, for example, the Administration has for many years supported federal legislation which addresses the excesses of current law. In other areas, there are questions which must be carefully considered of how the Federal Government can appropriately promote sensible tort reform within the framework of federalism.

Senator McConnell and others in the Congress have demonstrated a willingness to address the problem. We, at the Justice Department, look forward to working with this Committee on appropriate legislation.

That concludes my testimony, I will be pleased to answer any questions you might have.

Senator McCONNELL. Given your concern about the concept of federalism, what in your opinion is the appropriate role of the Federal Government to play in this crisis?

Mr. WILLARD. Senator, I think there are different roles that can be played, depending on the degree of Federal interest. In the area of product liability, for example, the administration has supported Federal legislation on the excesses of the system. It is our view that tort liability is creating a burden on interstate commerce and the power of the Federal Government to regulate interstate commerce under our Constitution is one that can be appropriately exercised to prevent tort liability from interfering as it has on goods that are made and sold in our national marketplace.

When useful medical products, vaccines, and other devices, are no longer available because of tort liability imposed in particular States, there is certainly a burden on interstate commerce. This is an area in which the Federal Government can become involved.

There may well be other areas where Federal involvement would be appropriate. As I mentioned in my testimony when I appeared before the committee last summer on the question of Federal contractor liability, I indicated that such concerns would be an appropriate subject for Federal legislation. The liability of Federal contractors is passed on, either directly or indirectly, to the Federal Government itself and paid for by Federal taxpayers. That provides a justification for Federal legislation.

And there may be other areas as well, and we are interested in working with the committee in exploring what are appropriate areas of Federal legislation. We do not, however, favor totally federalizing all tort law as a response to the crisis.

Senator McCONNELL. Is there any doubt that the civil justice system is experiencing a large increase in the number of claims filed? Is there any doubt about that?

Mr. WILLARD. I certainly do not have any doubt as to that. I can give an example from the Justice Department alone, that our report documents. The number of tort cases being handled by Civil Division lawyers over the last 10 years has about trebled, from about 4,000 to over 11,000 cases. The amount of money claimed in those cases against the Federal Government has gone up from less than \$1 billion to over \$200 billion. So certainly, in the cases we handle in the Civil Division, we have seen a vast expansion in the number of cases and the amount of money at issue in those cases.

Senator McCONNELL. The reason I ask that, my own experience as the chief executive officer of a local government for 7 years, a fairly good size one, was that we were experiencing an enormous increase in the number of cases filed, the amount of litigation. We went from a staff of roughly 8 lawyers to 60 in eight years; yet there are some witnesses who will come here today who feel that this is not happening. That is the reason for my question, because it seemed to me within my own experience at least and with other studies that I have reviewed that clearly the number of cases is on the upswing. That is your judgment then, is it?

Mr. WILLARD. It certainly is, Senator, and all of the people I have talked with who are familiar with this system generally agree that there is an increase in litigation.

Now, people can quibble about the exact size of the increase and how much of it is attributable to what factors. Since we have a vast civil justice system involving 50 different States as well as the Federal courts, it is difficult to collect and compare meaningful data on the precise amount of cases in each category. So you can always quibble about the statistics. But the fact that there has been a vast increase is one that I do not think reasonable people can disagree about, although they can disagree about the exact size of it.

Senator McCONNELL. I want to go back a minute to the federalist concerns that you have. What is an appropriate role, other than the product liability field, what is an appropriate role for the Federal Government to play in encouraging, shall I say, States to do something across the board in a broader way? As you know, my bill covers negligence, malpractice, and product liability, pretty much tort law across the board in Federal courts only. I am concerned about whether you view the—other than being a cheerleader—whether you view the Federal Government as having any appropriate role to play other than cheerleader to get something done in a broader way, because you are not denying, I assume, that there is a problem in medical practice, there is a problem with municipalities and others that do not relate strictly to product liability.

Mr. WILLARD. I certainly agree that there is a broad problem and it does affect a lot of areas outside of product liability, including very particularly professional liability. The problem is not limited to medical malpractice but includes the liability of other professions, architects, engineers, accountants, and even—as you mentioned in your opening statement—lawyers are having a malpractice problem, although you might say that is poetic justice.

Senator McCONNELL. We would say down home, the chickens are coming home to roost.

Mr. WILLARD. Similarly, municipalities are having a problem. But, I think municipal liability is a good example of something that under tort law is peculiarly a State responsibility. Municipalities are creatures of the States. Their liability is by and large defined by the extent to which States have waived sovereign immunity and created tort claim systems. For the Federal Government to pass legislation that would define the extent of municipal liability under State law would be intrusive and inconsistent with the strictures of federalism.

Senator McCONNELL. So our role would be to view with alarm but to go no further?

Mr. WILLARD. Well, I think that we can view all of it as part of an overriding problem. There has been too much of a tendency in the past to view each of these liability problems as being a special interest problem of a particular industry.

The doctors think they have a problem, or the municipalities think they have a problem and they do not recognize that it is all interrelated. So in terms of the analysis of our report—and I think in terms of this committee's analysis of the problem—is very useful to view it as an interrelated problem of the civil justice system.

Senator McCONNELL. Does that not argue for a comprehensive approach to the problem then, rather than a piecemeal approach?

Mr. WILLARD. Well, it certainly argues for a comprehensive approach. Our concern is that in terms of embodying that approach

in specific legislation at the Federal level, we have to be concerned about what is the power of our Federal Government under our constitutional scheme. Of course, there are different bases for that power and we are willing to work with the committee to look at appropriate kinds of legislation. We would not, however, favor a sweeping and total federalization of all tort law as a way of addressing the problem.

Senator McCONNELL. One of the troubling parts of being in the position that I am in and I think the position you are in is the egregious case—and we will hear some of them today, as you can imagine. Is there any way to deal with the truly egregious case, Mr. Willard, or do you feel that when you limit pain and suffering, as your working group recommended and as my bill proposes, you do not have that problem? Is there the problem of the egregious case and, if so, what if anything can you do about it and still try to cap pain and suffering?

Mr. WILLARD. Well, let me say first that we do not recommend and your bill does not place any limit at all on the amount that can be recovered for past and future medical treatment, rehabilitation, therapy, or past and future loss of income. In the egregious case, these losses can amount to millions of dollars.

When you have cases of quadriplegia, when you have cases of brain damaged infants, the economic damages in my experience, can easily amount to more than \$1 million. I have approved the settlement of a number of cases in excess of \$1 million with taxpayer money, confident that the money was necessary to pay for the cost of attendant care, rehabilitation, medical expenses, and so forth.

The question is what in addition to those very large sums of money should be paid for mental anguish, distress, loss of consortium, loss of enjoyment of life, pain, and suffering—there are a lot of different terms for it. This question requires us to confront the fact that no amount of money can compensate for a serious injury or the loss of a loved one, not \$10,000, not \$100,000, not \$10 million. I do not think that any of us would be willing to see a loved one die for that amount of money or to have a very serious injury occur.

So the question is how do you decide what kind of compensation is reasonable. Should that decision be made on a case-by-case basis by juries, as it is now, where one jury can award \$10,000 and another jury \$10 million? That is what I think has caused our legal system to come to resemble a sort of giant TV game show, or a lottery, where some people strike it rich and get millions and other people do not. Or, should the judgment be made by the elected representatives of the people in their legislative bodies?

Now, I do not think \$100,000 is a magic number. Some legislatures have adopted different numbers. California, for example, in its medical malpractice initiative, put a cap of \$250,000 on pain and suffering.

Senator McCONNELL. Let me interrupt you a minute. Given your concern about the disparity, is that not an argument for some kind of unified approach to this, maybe at the Federal level?

Mr. WILLARD. Well, it certainly is an argument for a unified approach to measurement of damages. I still believe that the Federal Government is a Government of limited jurisdiction and that a uni-

fied approach is appropriate where you have a clear basis for Federal jurisdiction. Generally speaking, though, many tort cases involve more matters of local concern and, just as your bill does not override the substantive law of the States, I do not believe that the law of damages needs to be absolutely uniform either unless there is some overriding Federal interest such as the interstate commerce provision.

Senator McCONNELL. I am sorry I interrupted you. I do not know whether you—

Mr. WILLARD. Well, I had about concluded. What I was trying to say was that these are really subjective determinations when you get into awards for pain and suffering, and I think there is a very legitimate basis for these judgments to be made, at least in terms of some kind of a cap, by legislative bodies, rather than allowing it to turn on the subjective determination of a judge or a jury.

I might add that putting the cap on this subjective element of damages ought to improve the efficiency of our system, allow more cases to be settled, and reduce transaction costs, including legal fees.

It has been my experience that most lawyers can agree pretty readily on what are the damages for lost income and medical expenses and rehabilitation. They might have a range of disagreement with the plaintiffs at the high end and the defense at the low end, but usually that is the kind of disagreement that can be compromised.

In my experience, what has really been the destabilizing factor in settling cases are awards for noneconomic damages and, of course, punitive damages; because those are totally subjective and unconstrained. It is very hard to value these damages because one jury might think it is worth \$10,000 and another jury worth \$10 million. That is a factor that makes it very hard to settle these cases. A cap on these damages would promote the efficiency of the system by making it easier to settle cases.

Senator McCONNELL. On the subject of how much the injured plaintiff receives, there is, of course, the concern about the contingency fee. Many argue that without the contingency fee cases will not be brought, legitimate cases will not be brought and that it is somehow inappropriate to in any way intervene in that fee arrangement and set a more reasonable fee. As we know, cases that are appealed, personal injury cases that are appealed typically the fee could go as high as 50 percent. I am wondering if you feel that a limitation on contingency fees would in any way keep people from filing the kinds of lawsuits they feel are legitimate.

Mr. WILLARD. I can first of all look at our own experience in the Federal Government, Senator. Under the Federal Tort Claims Act, there is already a cap on contingency fees of 20 percent for administrative claims and 25 percent for claims that are litigated.

As I indicated earlier, when you have lawyers willing to represent plaintiffs in suing the Federal Government under the Federal Tort Claims Act, it appears to me, from what I have seen, that plaintiffs have been able to obtain competent counsel.

I would like to point out that we did not recommend abolishing the contingency fee system—

Senator McCONNELL. I do not either.

Mr. WILLARD [continuing]. And your bill does not either. I think the system generally has worked well to assure that counsel is available to people who need representation and could not afford to pay a lawyer's hourly rate. It has a lot of other beneficial effects in terms of screening out frivolous cases.

The question though is whether fees should be unfettered or whether there should be some limit. Our view is that while a substantial percentage, 25 percent, is reasonable for small awards in order to adequately compensate plaintiffs' attorneys, when you get to the multimillion-dollar awards, a one-third or one-half contingency fee really produces an enormous windfall profit, if you will, to the plaintiff's attorney, far in excess of what is necessary to compensate for the legal representation.

So, as your bill and as our report recommends, we think it would be fair to impose some kind of a sliding scale on contingency fees to assure, particularly in the large dollar cases, that most of the money goes to compensate the victim and not to the lawyers.

Senator MCCONNELL. It could be considered, could it not, that a limitation on contingency fees might to some extent compensate for the cap on pain and suffering awards in the sense that the lawyers are going to get less and the plaintiffs are going to get more.

There is a case that will probably be discussed in testimony here today, the gymnast case in California, the \$14.7 million. I do not know whether it was settled or whether it was tried, but in any event the injured party received \$14.7 million. I asked the staff to figure the—I do not know what the lawyer got in that case, but on the assumption that he got 40 percent, he would have gotten a fee of \$5.8 million of the \$14.7 million. If he had gotten 50 percent, he would have got \$7.3 million of the \$14.7 million award.

Under my bill, the lawyer would have gotten \$1.5 million, still I think one would argue a rather nice fee in the case, and it would have put a significant amount of additional money back in the pocket of the truly injured plaintiff. So it seems to me that some kind of modification of the contingency fee arrangement is one of the best things we can do to put some money back in the pockets of those who are truly injured.

Mr. WILLARD. That certainly is an appropriate analysis of it, Senator. I might point out also that some people have suggested that this is a restraint on the free market and that people ought to be able to agree to whatever fee arrangement they want with their attorneys. But, I have seen very little competition, price competition among plaintiffs' attorneys in terms of a willingness to compete in terms of the percentage fee charged.

I realize that there are different percentages charged by different lawyers, but they all seem to hover pretty much around the accepted one-third, 40 percent, sometimes 50 percent if the case is appealed. If this were a truly competitive market that did not need to have some kind of Government regulation, there should be price competition. In a truly competitive market attorneys would be saying, "I will handle the case for a lower percentage." Instead, where they do seem to be competing is not in reduced fees but, rather, the attorneys say they can get you the big multimillion-dollar award making it worthwhile to pay them 50 percent.

So, I do not think it is a totally free market situation that we have here, for that reason, some kind of limitation would be appropriate.

Senator McCONNELL. I think that pretty well covers the questions I wanted to ask, Mr. Willard. I think your testimony is an indication of the problem those of us who would like to have a change run into, and that is what kind of change.

I made a speech the first of the week and discussed my bill and some of the other bills and on the way out a fellow stopped me and he said when are you all going to stop having hearings and do something, and I guess the question is what. And it appears to me from what you say that, outside of the product liability field, the administration's view can best be described as they view with alarm the problem but have some real reluctance to go into any area previously reserved for the States, with the possible exception of product liability.

So one of my concerns, as we go down this track, is that we end up with no unified approach to doing something about the problem, and I hope that evolves as we go along because it seems to me that there is clearly a problem of enormous proportions.

Thank you very much for coming.

Mr. WILLARD. Thank you, Senator.

Senator McCONNELL. I would like to call now Robert Cummins, who is executive vice president of Guardsman Elevator Co., in New York.

Mr. Cummins, thank you for coming.

**STATEMENT OF ROBERT F. CUMMINS, EXECUTIVE VICE
PRESIDENT, GUARDSMAN ELEVATOR CO., INC.**

Mr. CUMMINS. Good morning, Senator. My name is Robert F. Cummins, and I reside at 31 Pondfield Road, West, Yonkers, NY. As you stated, I am the executive vice president of Guardsman Elevator Co., which does business at 276 East 150th Street, Bronx, NY.

Guardsman Elevator is by most standards a small business and—

Senator McCONNELL. Could you pull the mike a little closer to you?

Mr. CUMMINS. Guardsman Elevator is by most standards a small business and, quite frankly, my title seems a little more important than it really is. I am very basically one of three people who own and operate this elevator company.

We provide elevator maintenance and repair service for our clients on a contractual basis in the New York metropolitan area. The company employs 24 people. In 1979, our first year of operation, we had gross sales of approximately \$285,000. This year, our gross sales estimates may well exceed \$1.6 million. We are very proud of that growth record, because it is due in large part to our working 6 and 7 days a week for the past 6-plus years.

We think that our success in this highly competitive industry—as there are more than 200 firms in our area providing like services—is a function of our basic philosophy which is to provide a quality service, 24 hours a day, 7 days a week, 365 days a year, at

competitive prices. One thing that we always do is we continuously reinvest our profits back into our company to assure our growth.

The No. 1 problem facing our company this year is liability insurance. It is a problem that threatens our very existence.

In October 1985, when our annual insurance premium renewal date came up, we were faced with the very real prospect of closing our doors because of an inability to obtain liability insurance. And that inability to obtain insurance was not based on our safety record. It was based on the fact that there just is not anybody out there writing insurance.

Finally, at the 11th hour we did obtain insurance, but the cost skyrocketed. We are now paying 500 percent more for one-sixth of the amount of coverage that we did 2 short years ago. Our premiums went from \$32,000 for \$6 million worth of liability coverage, to more than \$150,000 for \$1 million in coverage.

This liability crisis, coupled with the horrendous trends in litigation, have had a crippling effect on our industry. Standard increases are now 3 to 500 percent, with declining limits of coverage, and the small business man is feeling the burden of this explosion in rate increases.

One thing that should be of great concern to everyone here is that it is having disastrous effects on our growth potential, on our capability to expand jobs, and our profits.

We have experienced a proliferation of what would reasonably be considered frivolous lawsuits in the past few years. Insurance companies it seems would rather settle baseless lawsuits for a fraction of the legal fees required to fight and win a case. This attitude and the present contingency fee system for lawyers is killing the small businessman.

The principles of truth and justice seem to have been replaced with the principle of greed and the search for the deepest pocket.

There are a couple of cases which come to mind which I would like to cite which we have had personal experience in which would illustrate my point. One has to do with—the title of the case was *Wendt v. Guardsman Elevator*. The case has since been settled in the State of New Jersey and it revolved around a gentleman who lived on the second floor of an apartment building where we maintained the single elevator.

The man was in his sixties and he had a history of a heart condition. He died at work of a heart attack. At work he was reportedly a handyman or a janitor at an industrial complex where, as we understood it, he regularly did strenuous work.

We were performing major elevator repair work during the week preceding the man's death. This elevator work required us to remove the elevator from service completely. We did complete the repairs on the 40-year-old elevator and we returned the elevator to service without any delay.

We were held liable in the man's death for \$20,000.

The second case which I would like to cite is *Carmen Martinez v. OUB Houses and Guardsman Elevator*. Mrs. Martinez allegedly had an accident in a building which we had under maintenance contract. Our records showed that there were no calls for service, there were no abnormal reports. Neither the site manager nor the full-time building superintendent were aware of any incident and

none of the people who would normally be involved in the type of incident alleged knew anything about it, so naturally we suspected that nothing really happened at all.

We were appointed legal defense by our insurance company, which is required, and during my first discussion with my appointed counsel I was told that we have to oppose this motion for summary judgment that Mrs. Martinez's lawyer had made. Then my counsel left on vacation and he told me, "I will be back in a couple of weeks and I will be in touch with you then."

Six weeks went by and I called him. I spoke to his secretary and I was told that the case had been settled. I found out through my insurance loss record that it cost me under my policy \$5,000 for that settlement. I later found out that there was a great push to settle that case because of the fact that the building owner's insurance company was in the process of liquidation, because I questioned the wisdom of such a settlement.

Then I continued to look, continued to ask, and I found out that during the process of the liquidation of the insurance company there is a deadline and after that deadline attorneys fees are not paid.

Despite the incredible nature of Mrs. Martinez's claim, it kind of appears to me that one attorney gave another a professional courtesy, if you will, at my expense. Of course, I cannot prove that, but you know to date nobody else has been able to provide me with a reason that would make me think any different.

These two lawsuits that I have mentioned, they are not the exception, they are the rule. Each and every lawsuit, no matter how baseless, takes me personally away from my business anywhere from 14 to 30 working days for preparation, investigation, for discovery, examinations before trial, and for testimony. That is time without compensation. That is an unrecoverable loss to my business. You know, these losses are unrecoverable even if we fight and win the case.

We have all heard about how the insurance crisis is hitting the doctors and the large corporations, but the small businessman is carrying an even greater burden. The guy who works 6 and 7 days a week to try and make it all work, he does not have the time nor the money to hire lobbyists or to form political action committees, so he is faced with either paying the freight or closing his doors.

As I talk to other small businessmen, I find that my experiences are not atypical, but they are frighteningly similar, and they are threatening our very existence.

I would like to thank you for the opportunity to come before you today and I would be happy to answer any questions.

[Letters pertaining to litigation and copies of trial transcripts are retained in committee files due to their length:]

Senator McCONNELL. Thank you, Mr. Cummins. Let us go back over just quickly here some of the points that you have made. How much of your time and effort did you indicate were devoted to defending the lawsuits that had been filed against your company?

Mr. CUMMINS. There are basically three principals in this organization and we all wear several different hats. I usually handle any litigation that comes through. It takes me anywhere from 14 to 30 days, working days, not calendar days but working days, to prepare

for defense, prepare testimony, et cetera, which is time away from my business. I do not have a risk management department.

Senator McCONNELL. So how much of your time on a percentage basis are you spending dealing with—

Mr. CUMMINS. Probably about 12 to 15 percent of my total time.

Senator McCONNELL. How many cases of the type that you have mentioned have been filed against your company?

Mr. CUMMINS. I believe it is 12, Senator.

Senator McCONNELL. Does the insurance situation that you find yourself in affect the number of jobs that you provide in your community?

Mr. CUMMINS. The elevator business is a very technical business. When we take someone in on an apprenticeship program, it is usually, depending on that individual's capability, anywhere between 3 and 5 years before they are proficient enough to actually go out and become a mechanic and work on elevators.

After my insurance premium renewal—my premiums are based on payroll—I had to take a healthy look to see if there was any fat in my payroll. I found out that the fat was in my apprenticeship program where we were grooming younger folks to come on board and giving them the knowledge and the training it would take for them several years to be a great asset to us, to be good elevator mechanics. We scaled that apprenticeship program back 40 percent, Senator.

Senator McCONNELL. What do you think is the most important thing we could do here in the Congress to help solve this problem?

Mr. CUMMINS. Well, S. 2046 has I think a lot of longterm type suggestions that—really I am not going to see next year, but in a few years when we stop seeing or when we hopefully see less frivolous lawsuits being brought, hopefully insurance companies will start sticking to principles and fighting for what is right, instead of saying let us settle.

I think the bill is sorely needed for the small businessman, for the large businessman, and for everybody.

Senator McCONNELL. Thank you very much, Mr. Cummins. I really appreciate your coming.

Mr. CUMMINS. Thank you.

[A newspaper and a magazine article follows:]

Banks May Restrict Borrowing by Firms That Have Liability Insurance Troubles

By PHILLIP L. ZWIEG

Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—Companies that have lost much of their liability insurance coverage and must pay steep premiums for what they have left may be faced with another blow: increased difficulty in getting credit on favorable terms from their banks.

Bankers acknowledge that, despite weak loan demand and strong competition for corporate lending business, some have begun to take a tougher stance when lending money to companies vulnerable to damage claims.

Interviews with officers at several banks indicate that the availability and cost of liability insurance has lately become a much more important factor in credit decisions at these institutions. The banks include such major New York institutions as Chemical Bank, Morgan Guaranty Trust Co. and Manufacturers Hanover Trust, and regional banks such as Pittsburgh-based Mellon Bank, Atlanta-based Citizens & Southern National Bank and Banc One, Columbus, Ohio.

Industries Surprised

Meantime, several trade groups in industries pinched by the liability-insurance crisis indicated they were surprised that banks have begun to link the insurance crisis with lending practices.

So far, the most tangible evidence of this change is in demands by bankers for security to back up loans that previously were unsecured, or in tougher language in loan agreements to give banks first claim on corporate assets if lawsuits are filed. But bankers warn that some companies with insurance problems could face reductions in their credit lines, increases in borrowing costs or difficulty in getting any credit at all because of increased risk.

These include small and medium-sized companies with financial conditions that have been weakened by steep premium increases, and underinsured companies of all sizes that are vulnerable to liability claims and big jury awards. In the past year, companies in a variety of industries, including pharmaceuticals, chemicals, recreation, consumer products and trucking, have been slapped with huge premium increases while coverage has been slashed by more than 50%. Property and casualty companies, faced with staggering underwriting losses, have stopped underwriting certain risks.

'Our Problem'

"What turns out to be a problem for our borrowers becomes our problem," says Malcolm T. Murray Jr., executive vice president of First Union National Bank, Charlotte, N.C. "We've seen some companies not being able to get credit, and we're requiring collateral on what might have been an unsecured situation."

Raymond A. Pomante, manager of the financial service group at Philadelphia-based Alexander & Alexander, a major insurance broker, says that "lenders are taking a much harder look at who they're lending to and how much they're lending" because of the insurance crisis.

The companies most vulnerable to changes in bank policy are those in such specialized industries as day care and ski-lift manufacturing, which have been the targets of especially drastic reductions in coverage by property and casualty insurers, bankers say.

John G. Jennings, vice president of Poma of America Inc., a ski-lift builder, says that the Grand Junction, Colo., com-

pany recently paid off bank loans just before its insurer cut back liability coverage. "We're not sure what the bank's reaction will be the next time we have to borrow," he says.

The chief financial officer of a supplier of day care services says the company's bank recently demanded a change in its loan agreement that requires it to maintain a specific minimum level of liability coverage, instead of simply requiring that the coverage be "adequate." However, according to Mr. Pomante of Alexander & Alexander, many banks are agreeing to lower levels of coverage.

Mindful that a total of about 40 property and casualty companies failed in 1984 and 1985, some banks are also instructing lending officers to investigate the financial condition of their borrowers' insurance companies. Chemical Bank, for example, in a recent memo, not only told credit officers to ascertain the adequacy of borrowers' coverage, but urged them to consult a special unit at the bank if they had questions about the financial stability of insurers.



Fact and Comment

By Malcolm S. Forbes, Editor-in-Chief

MORE "TORT"URE

One of our real history-making battleships is kept moored in almost mint condition on the Delaware River not far from Philadelphia's Independence Hall. The *Olympia* was Dewey's flagship, and from it in Manila Bay during the Spanish-American War he gave his famous order, "You may fire when you are ready, Gridley." The result was the destruction of Spain's Pacific fleet and the beginning of our intimate ties with the Philippines, Puerto Rico, Guam and, for a time, Cuba.

Thanks to the nonprofit Cruiser Olympia Association's volunteers and hard-to-come-by donations, this floating museum brings that bit of epic U.S. history alive. Now it's threatened with a torturous demise.

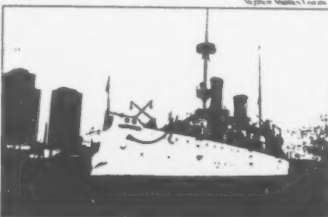
A while ago, a deckhand on the berthed ship fell overboard and drowned. His father sued the Association for failure to salt or sand the icy gangway and do other things to insure the maintenance crew's safety. The jury decided the deckhand's father should receive \$237,000 in damages plus \$13,000 interest. U.S. marshals are awaiting legal clearance

to padlock the ship and auction it off to satisfy the judgment. Meanwhile, the Association has been given 90 days to raise the money through donations.

In a first-rate *Citizen's Guide To Tort Reform*, doubly effective because it is concise, clear and fair, CEO Bill McCormick of Fireman's Fund Insurance Cos. cites this example of a "comparative negligence" tort case:

"A New York man was seriously injured when he attempted suicide by jumping in front of an oncoming subway train. He filed a lawsuit claiming that the train engineer should have stopped the train faster. The man recovered \$650,000 from the New York Transit Authority."

Before you find yourself uninsurable on many fronts because such horrendous award abuse makes insurance unaffordably impossible, send to Mr. McCormick, at 777 San Marin Drive, Novato, Calif. 94998, for a copy of the Guide and his recent speech, "A Time to Rebalance the Scale of Justice."



Senator McCONNELL. For a different point of view, I would like to call now our first panel, three lawyers, Peter Perlman, who is president of the American Trial Lawyers Association; Aaron Broder, with Bailey & Broder, in New York; and Ned Good, from Good & Novak, in Pasadena, CA.

Gentlemen, it is good to see you.

I would like to call first on Mr. Perlman.

STATEMENT OF PETER PERLMAN, PRESIDENT, ASSOCIATION OF TRIAL LAWYERS OF AMERICA; AARON J. BRODER, BAILEY & BRODER, NEW YORK; AND NED GOOD, GOOD & NOVAK, CALIFORNIA

Mr. PERLMAN. Thank you, Senator.

Senator McCONNELL. I might say that Mr. Perlman is from Lexington, Kentucky, maybe that is why I called on him first.

Mr. PERLMAN. I am a fellow Kentuckian. Thank you, sir.

Senator McCONNELL. Go right ahead.

Mr. PERLMAN. As you stated, Senator, my name is Peter Perlman, and I am a practicing lawyer in Lexington, KY. At the present time I have been elected to serve as the president of the Association of Trial Lawyers of America and I am here today in my own capacity and in that capacity. We are an organization of some 60,000 lawyers and I appreciate your having me appear before this committee and I commend you for looking into this matter which has become front-page news, editorial page news, major television coverage, and I agree that there is a crisis.

I do not agree that the crisis is within the justice system. It is my position that the Litigation Abuse Reform Act, as it is entitled, deals with eliminating wrongs, but in effect S. 2046 eliminates rights.

The insurance crisis is present, there is no doubt about it. It is a crisis of immense proportion, covering every facet of American life. But I will tell you, Senator, that the attempt to place the lack of insurance, the unavailability and the increased cost of insurance at the feet of the trial lawyers, of the jurors, of the people who serve on juries, the judges, and to blame all the trial lawyers and accuse them of being greedy, to call the people who give willingly of their time, soft-headed, to state that the judges are violating their duty and not enforcing the law, as many of the accounts urging drastic limitation of individual rights have done, is totally in error.

You stated in your opening remarks, Senator, that there are those who state that the insurance industry, by its underwriting practices, by the cyclical and roller-coaster nature of their experience, have caused this problem. I am among those, and I am not the least bit modest to tell you that the records and the documents that we will furnish in the record demonstrate that the cause of the present insurance crisis is the insurance industry themselves.

The authoritative works, not the trial lawyer works but the authoritative works from within the industry themselves document that fact. Business Week just last week—and that is certainly not a trial lawyer publication—stated very clearly that the insurance industry must account to themselves and to the people for the biggest portion of that blame.

Now, let me talk a little bit about the specifics and some of the language in the preliminary and also that is contained in the bill. To begin with, Senator, authoritative studies demonstrate that Americans are no more likely to sue than citizens of other industrialized nations. In fact, we are not even more likely to sue than our forefathers were many years ago.

Substantiation simply does not exist for the claim that we are a litigious society. For example, in the Federal courts, to which you have made reference, there has in fact been an increase in filings. However, the Federal Government itself, through claims for overpayment of benefits on student loans, has been largely responsible for the biggest increase in those benefits. And I might state for the record that the Federal court system, the 1986 budget request is \$1.1 billion. That sounds like a lot of money, but it is actually one-tenth of 1 percent of the entire Federal budget.

The size of jury verdict awards is another statistic that is consistently misstated and distorted. The facts and the most authoritative study done on this subject has found that almost 90 percent of all jury verdicts involve less than \$50,000.

The big verdict, while it makes good headlines, is in fact very rare and it is awarded in cases where there is catastrophic damage, quadriplegia, wrongful death, amputation, and brain damage constitute 70 percent of the multimillion or in excess of \$1 million category.

The bill which you have proposed, Senator, seeks to place caps on an individual's pain and suffering. As an attorney and as a distinguished former county judge in my own State, in Jefferson County, you know that trial lawyers, no matter whether they represent the victim or a wrongdoer, they will tell juries that anything less than full justice is injustice. And the poets have said, and we believe, that pain is perfect misery, the worst of all evils, and we know that when it is our own rights that are involved or those of our family, we are hesitant to place a value on pain, yet this bill seeks to give away the rights of individual victims to be compensated for their pain.

The collateral source rule which is addressed by the bill, the effect of that would be to make the wrongdoer the beneficiary of the victim's collateral sources, which usually are an insurance policy. That is a grossly unfair proposal.

I commend you and Mr. Willard on your recognition of the contingent fee and its place as the victim's key to the courthouse. However, to place limits as the sliding scale which you have proposed unfairly discriminated against those that are most severely hurt and those that are least able, that is those with the most serious and the most catastrophic injury.

It is very seldom pointed out that the victims, those who are in litigation, they are never here complaining about their lawyers' fees because they know it is fair, they know it is just, and they know that that is the victim's key to the courthouse.

Some references were made to the effort to improve the efficiency and to place limits. Let me remind you, Senator, that there is a place where there are such limits, where there is a cap on noneconomic damages, where there are no contingency fees, not just a limit but not contingency fees, where there are very few jury trials.

That is in Ontario, Canada, and that Province and the city of Toronto is experiencing the greatest insurance crisis in its history. The city of Toronto had to recently go bare. So if you say that this is the answer to the insurance crisis, there is proof that it is not.

Also in Wisconsin and in Pennsylvania there have been limits on municipal and governmental immunity, in those States there have been drastic limits, much lower than those contained in your bill, and in those States today they are again facing the same insurance crisis.

Restricting caps will obviously help big business, help small business, help those who insure all of our American institutions, but it will make the entire system of justice grossly inequitable and unfair to those that need it the most and that is the victims.

Each of these proposals, Senator, in due respect, and the bill in its entirety would destroy the social and legal fabric of accountability that is at the heart of our democratic system of justice and that is unique to America, that anybody can take on General Motors in the smallest county in their State and have a fighting chance.

Mr. Chairman, that completes my remarks. I have prepared a statement with various attachments that will be a part of the record.

Senator McCONNELL. Yes, we will insert your full statement in the record, and I think we will move through the others and pursue questions at the end.

[The prepared statement of Mr. Perlman follows:]

TESTIMONY OF

Peter Perlman

President

Association of Trial Lawyers of America

Mr. Chairman, it is ironic that the bill being considered this morning bears the title "Litigation Abuse Reform Act." Reform is traditionally associated with the elimination of wrongs; S. 2046 eliminates rights.

It is a bad bill.

It is unjust; it would seriously undermine our best deterrent to reckless and negligent conduct and it attacks that very institution - the jury system - that identifies us as a nation of both liberty and responsibility. Furthermore, it is a bill for which there is no demonstrated need. S. 2046 is not only very bad medicine, it is a cure for which there is no known disease.

Having stated at the outset that we find S. 2046 to be bad legislation, let me add that we also find the underlying subject matter to be of great importance. The issues raised are not frivolous. After so much irresponsible rhetoric has been generated about the present state of our civil justice system, the Association of Trial Lawyers of America welcomes a genuinely serious inquiry.

It is that sort of serious inquiry - an inquiry that shuns rhetoric in favor of facts - that I hope my testimony will facilitate.

As a starting point, S. 2046 purports to address a "crisis" which in fact does not exist.

At the time this bill was introduced in February, its sponsor placed in the Congressional Record a statement which read in part:

This bill . . . addresses a severe and growing crisis - the crisis of "hyperlexis." It is a new word, Mr. President. It means essentially too much litigation. In other words, the excessive and unrelenting resort to the litigation process to solve almost any problem imaginable.

The problem is serious, for resort to litigation, without restraint, threatens to choke off the vibrance of our economic well being.

I have to ask, very simply, on just what basis (if any) are those assertions made? I can tell the Committee this: they seriously misread the facts.

I find it interesting that the statement in the Congressional Record asserts the problem without providing extensive factual substantiation. I think there is a good reason for that. Substantiation for a contention that we suffer from "hyperlexis" does not exist.

In truth, there are very few recognized studies that provide illuminating data in this area. Serious research on these matters has been limited, a detail not made reference to by those who speak loosely about "litigation explosions." We have examined carefully what research does exist and the conclusions may surprise you.

Generally recognized as the leading work is that of Professor Marc Galanter whose very extensive research is outlined in a work entitled Reading the Landscape of Disputes: What we Know and Don't Know (And Think We Know) About Our Allegedly Contentious and Litigious Society. That work, originally prepared as a paper and first published in the UCLA Law Review two years ago, was supported and funded by Harvard Law School, the American Bar Association, the National Institute for Dispute Resolution, Control Data Corporation, General Motors Corporation, and the Gillette Company.

The central conclusions of that study are twofold:

- 1) that Americans are no more likely to sue than citizens of other major industrialized nations;
- 2) and, perhaps even more significantly, that Americans today are no more likely to sue than they used to be.

Probably the only other recognized research into litigation frequency has been done by Dr. Stephen Daniels. His work, which has been published in the Judges' Journal and the American Bar Research Journal, not only substantiates Galanter's but gives us additional insights.

Examining rates of litigation - that is cases per 1,000 population - Daniels demonstrates a more litigious America in 1820, 1850, and 1900 than presently.

Dr. Daniels concluded in 1984 that "predictions about ever-increasing caseloads leading to the inevitable collapse of the court system are simply out of place." And a year later in publishing data gathered from his studies of the state court system in Illinois, Daniels speculated that "... a substantial amount of resources and attention is being invested in attempting to solve a problem either that has not been properly defined or does not really exist."

Note also, please, Professor Galanter's conclusion after examining all of the claims regarding "hyperlexis" and comparing it to the facts developed by actual research:

We have seen the announcement of general conclusions as to policy on the basis of very casual scholarly activity. The information base was thin and spotty; theories were put forward without serious examination of whether they fit the facts; values and preconceptions were left unarticulated. Portentious pronouncements were made by established dignitaries and published in learned journals. Could one imagine public health specialists or poultry breeders conjuring up epidemics and cures with such cavalier disregard of the incompleteness of the data and the untested nature of the theory? If the profession's claim to expertise in such matters are disputes and litigation is to be taken seriously, it will need to adopt ground rules to require more respectful touching of the data bases. It will have to recognize that the collection of data and the development of coherent and tested theories

for interpreting it are an inescapable collective responsibility of a group that purports to proffer expert opinions about the arrangements of public life. The career of the "litigation explosion" literature does not offer much reassurance that the legal profession and legal education are prepared to exercise such responsibility.

Mr. Chairman, I do not wish unnecessarily to extend my testimony at this point but if it is the Committee's wish, I would be pleased to submit for the record in its entirety the UCLA Law Review article and one of the articles by Dr. Daniels. Those studies not only substantiate our own viewpoint, but, in truth, they represent the only academic research that has been done in the field. If Members or staff of the Committee know of any additional research studies, pro or con, we would be eager to review them.

I am convinced, however, that when the true facts are examined the conclusion will be inescapable. As the Honorable Patricia Wald, a United States Court of Appeals Judge for the District of Columbia Circuit (and a former Assistant United States Attorney General) wrote recently:

....Americans' use of the courts is actually conservative. There is no radical departure from prior patterns in the United States or even from patterns in many other industrialized nations.

How then did this myth of an overly litigious society develop? How is it that we have reached a point where statements are placed in the Congressional Record bemoaning a "hyperlexis" that doesn't exist and where as a result legislation is proposed that would deprive our citizens of rights developed and held over centuries?

A large part of the answer, I am afraid, lies in a willingness on the part of the critics of our civil justice system to rely for data on anecdotes and impressions rather than on a commitment to engage in the hard work necessary to uncover the true facts.

Typically cited as evidence of "hyperlexis" are:

1) incomplete and out of context data such as mere gross caseload statistics or so-called "average" jury verdict awards;

2) anecdotal references, on the one hand, to huge "monster cases" (such as the AT&T divestiture or the IBM antitrust suit or cases resulting in multi-million dollar verdicts) that critics contend swallow up vast resources and constantly drive up the cost of litigation; or anecdotal references, on the other hand, to some petty claim that supposedly proves that every dispute ends in litigation; and

3) the so-called "horror story", anecdotal references usually to the same half dozen or so cases that supposedly produced outrageous or extravagant results.

The fact is that none of these pose real problems, certainly not problems that require for solution the adoption of radical legislation that would limit our citizens' access to justice.

Let us look at reality, not rhetoric.

Gross caseload statistics supposedly demonstrate that we have become overly litigious. Yet we have seen that research shows that rates of litigation - cases per 1,000 population - reveal that we litigated more in the nineteenth century than presently.

This bill, S. 2046, relates to federal proceedings so let's look at the federal courts. It is often cited, for example, that twice as many cases were filed in the federal courts in 1983 as in 1975. But what is not cited is that much of that increase consisted of a jump from 600 to 41,000 of cases filed by the federal government itself to reclaim overpayment of veterans benefits and social security benefits or to collect on student loans. And the next largest increase and a good bit of what remains of the total increase was a jump from 3,000 to 20,000 in cases to restore disability payments cut off by the Reagan Administration. Those numbers do not indicate any across the board increase in our litigiousness, they reflect very specific political events. It should be noted that during this same period, antitrust cases in federal court declined by 15 percent, truth-in-lending cases declined by 50 percent, and class actions in federal court dropped by 66 percent.

The size of jury verdict awards is another statistic consistently misstated by critics of our system and reported incompletely and out of context by the media. I raise that issue because a limitation on damages - a cap on awards - is a prominent feature of S. 2046 and is in fact the very first feature mentioned by its sponsor in the statement that accompanied introduction of the bill.

That caps on awards are unwise and unjust and that such caps do not result in reduced insurance premiums are also points that need to be made, and they will be made later in this testimony. My purpose here is simply to show that the claims we so often see and hear regarding "uncapped" awards are not supported by the facts. The facts show the system to be far more responsible, in fact, than those who distort statistics in an attempt to subvert it.

It is reported that in 1984, the "average" product liability award was \$1.07 million and the average medical malpractice award was \$950,000 thousand. We see those figures quoted constantly by critics of the jury trial and by the media and we hear them submitted as testimony to congressional committees.

Now, Mr. Chairman, to those of us who try these cases, those figures seemed astonishing. They seemed totally out of line with reality.

Our research revealed the origins of the "averages".

They come from Jury Verdict Research, Inc. (JVR) of Solon, Ohio. JVR is a reputable firm that can and does provide useful information, but it does not compile all verdicts, a fact it readily admits. Therefore, it must never be used as an indicator of the "average" size of awards or the typical result of a case. JVR only records those verdicts of which it receives notice. It receives notice of many large awards but not all the modest ones. This fact alone skews the "average" way upward. More importantly, the JVR figures do not average in settlements (which are generally lower than verdicts), they do not reflect reductions in verdicts which often occur in the appellate process and they do not include verdicts where there were no awards to plaintiffs, which account for over 50 percent of all cases.

But it is not Jury Verdict Research, Inc. that is at fault for the gross misuse of these so-called "averages". It is the critics of our civil justice system. JVR is very up front about the limits of its service and it points out regularly that its figures must be viewed carefully for a number of reasons. One of the things it makes clear, for example, is that its summary of verdicts does not include those for the defense which contain no awards. And as JVR adds: "Whenever considering medical malpractice and products liability cases, it is important to bear one fact in mind; less than one half of these cases result in a plaintiff verdict when tried by a jury."

And yet as recently as last week critics of our civil justice system cite these JVR figures as "averages" of all jury awards and, of course, the media reports that. And as recently as last month critics of our trial by jury system submit them to the Congress as testimony and, of course, the media reports that.

Well, it just aint so.

Mr. Chairman, the more one seeks to ascertain the facts, the clearer it becomes that there is no demonstrated need for radical legislation such as S. 2046.

What about the claim that for one reason or another - whether it is our imagined overlitigiousness or the development of the modern day "monster cases" or the supposedly incessant filing of petty lawsuits - that the cost of litigation has become a serious public concern. That contention was also put forward as a reason to enact this bill.

Again, let's just look at the facts.

S. 2046 would apply to federal judicial proceedings so we checked the fiscal year 1986 budget request for the entire federal court system. It is just over 1.1 billion dollars. That, Mr. Chairman, is about one-tenth of one percent of the federal budget. Is that excessive for one of our three co-equal branches of government? Is that a serious overexpenditure of resources for the administration of the system that protects our most basic rights?

What about the cost effectiveness of the system for litigants? Here too, as in the matter of our supposed "hyperlexis", when we set out to examine the available data we discovered that notwithstanding all the rhetoric the actual research was limited.

We learned that the most extensive work done was developed recently by a group of three University of Wisconsin professors, a professor at Amherst College and a senior social scientist at the Rand Corporation's Institute for Civil Justice.

The work of that group has come to be known as the Civil Litigation Research Project and its results are fascinating. The Project produced a summary and three volumes so it would be difficult to summarize all of its findings here. But the researchers did conclude that from the point of view of the litigant, the cost of most ordinary litigation is not excessive.

It is also interesting to look for a moment at the random sample of 1600 cases examined by the Civil Litigation Research Project. The study reveals that the large case, for example, is a rare phenomenon. More than fifty percent of cases dealt with disputes under \$10,000 and only twelve percent involved claims of greater than \$50,000. The study further established that more than ninety percent of disputes are resolved without litigation

and that ninety percent of the cases that are the subject of lawsuits are settled before verdict.

We also came across an interesting article in the February 1985 issue of Best's Review. (A.M. Best Co. is often cited as the authoritative source of insurance industry data.) According to the author of that article, ninety-eight percent of all property/casualty insurance claims filed are resolved without going to court and only four of 10,000 are tried to a verdict.

Finally, please note the following excerpt from the "Conclusion" section of one portion of the Civil Litigation Research Project report on the costs of ordinary litigation. It is remarkably similar to the conclusions we found in the research done on "hyperlexis":

We have reported on the first large-scale empirical study of litigation and its costs. Our description of the world of ordinary litigation often seems at odds with the image held by many in the public and some in the legal professions . . . The literature on costs suggests that litigation may be too costly for litigants and society, and finds the causes of such excessive costs in the complexity of procedures, the unchecked adversarial zeal of attorneys and the biases of existing fee structures.. Our data suggest, however, that at least from the litigant's point of view, most ordinary litigation is cost-effective .. we doubt whether the system is in crisis...Finally, we are compelled to ask how the legal profession defines problems and provides solutions in an area like litigation and dispute processing. Why is there such a wide gap between the world described in the reform rhetoric and the world we observed?

Mr. Chairman, the reason the rhetoric does not match the reality is that the rhetoric is part of a calculated effort to dismantle our system of trial by jury; it is no accident that as the half truths and distortions proliferate we see legislative proposals such as S. 2046 that would eliminate people's rights. We must not allow that to happen.

Our policy makers must not be willing to receive as facts what are really nothing more than bare half truths. The use of the so-called "horror story", amounting to the telling of tall tales, is just another attempt to mislead the public and to mislead the policy makers into believing that juries give huge sums to undeserving victims which results in higher costs for us all.

It is usually the same six or seven stories that are paraded before the media - and every one of them is untrue or materially distorted. We have looked into each of them - the so-called "burglar who fell through the skylight" case, the so-called "refrigerator strapped to the body builder" case, and half a dozen others - and in each case our research revealed nothing horrible about the "horror stories" except for the injuries.

I do not wish to enumerate each of those cases here although to do so would further illuminate how dishonest some of the debate has become. I would be pleased to submit for the record, however, a short ten page discussion of the real facts behind each of these "horror stories." And if I might, I would like to comment on one case in particular because it was mentioned as one good reason to enact this bill.

The statement in the Congressional Record that accompanied the introduction of the bill spoke of a 14.7 million dollar award to a gymnast in California who suffered a neck injury in a gymnastic accident and who recovered from the manufacturer of the gym mat on the theory that the company failed to warn of the potential danger.

We checked the facts, which are these: High jump mats are designed entirely differently than gymnastic mats and the company which manufactured those mats in this case was aware of that significant fact. Yet it marketed and distributed its high jump mats as gymnastics mats without warning of the danger of interchanging their use. The young gymnast in this case landed on the high jump mat and was severely injured.

He is now a quadraplegic, requiring a 24-hour ventilator and a fulltime registered nurse. At the time of trial, he had already accumulated 2.5 million dollars in medical expenses, and had future projected medical expenses of 8.9 million dollars. His loss of earnings, conservatively, was estimated at between \$500,000 and one million dollars. Is a 14.7 million dollar award which includes pain and suffering as well as economic loss under these circumstances irresponsible and unjust? Or is eliminating the rights of victims such as these the real injustice?

At no matter how many different angles one views the true facts, the civil justice system in America does not present a picture of an institution in genuine crisis. And yet here we are today discussing legislation to eliminate rights, proposals that would restrict access to justice. That would be very, very serious business even if our system of trial by jury had failed us and it is unthinkable since it has not.

Mr. Chairman, let us look at what is in this bill: caps on awards, elimination of the collateral source rule, limits on punitive damages and limits on contingent fees.

Do we seriously think it is just to reduce the rights of those of our citizens who are most seriously injured by reckless or negligent conduct? Well that is precisely what S. 2046 would do; that is exactly the result that a \$100,000 cap on pain and suffering awards would have.

And just where is the "crisis" that the imposition of these cruel restrictions is supposed to eliminate?

We have looked at what facts there are about million dollar verdicts in personal injury cases and we have discovered two interesting things. One, the big verdict is very rare and two, it is awarded only in those cases where the plaintiff has been very seriously injured or is completely disabled and may require medical care for life.

Jury Verdict Research, Inc. has a record of 1,642 million dollar verdicts given to individual plaintiffs since 1962. Of those awards, more than 1,100 were made in four injury categories: permanent paralysis, 268 cases; permanent brain damage, 338 cases; wrongful death, 362 cases; and amputation of leg or arm with multiple amputations common, 161 cases.

It is these victims at whom S. 2046 is aimed but it is the rights of all of us that are at stake. Any one of us may some day face the tragedy caused by the negligent or reckless conduct of a drunk driver or the injury caused by a defectively manufactured product or any of a host of unpleasant possibilities.

To eliminate our rights in the face of that kind of tragedy is unthinkable when our jury system has in fact been such a just institution over two centuries of our national life.

It is unjust to cap awards and it is not wise. It would reduce the prime deterrent to unsafe conduct in the marketplace and act as a disincentive to product safety, for example, and to prudence by medical and legal professionals.

It is also unjust to eliminate the collateral source rule. Is it just to make the manufacturer of a defective product or the perpetrator of the negligent act the beneficiary of a victim's insurance policy? Is it wise that such proceeds should accrue to the tortfeasor rather than to the insured victim?

And what of the limits on contingent fees? Of all the attacks on our present civil justice system, attacks on the contingent fee system make perhaps the least sense.

If the goal is to limit litigation, to prevent the frivolous lawsuit, then it only takes common sense to understand that the very best disincentive to the nonmeritorious claim is the contingent fee. If a claim has no basis, or even if it has a basis but is unsuccessful, the attorney will receive zero. That is: zero minus the time spent on the case and the cost of investigation, preparation, securing expert testimony, taking depositions, obtaining and examining documents, and litigation. Add to this the risk of stern disciplinary action under local rules if a lawyer brings a frivolous action, and it becomes very clear that a lawyer is not going to waste time on unworthy cases under a contingent-fee system.

Beyond that, and of maybe greater importance, the contingent fee is the only key to the courthouse for millions of Americans. There are no limits on defense fees, no limits on what the wealthy client can pay his or her attorney. A limit on the contingent fee discriminates against plaintiffs - those often least able to afford justice.

It is interesting that complaints about contingent fees never come from victims but from those who must pay settlements and awards.

As long ago as 1973, a U.S. government study prepared by the then Department of Health, Education and Welfare in a report on medical malpractice stated plainly that "when the amount plaintiff's attorneys can collect is contingent on whether they win in a case that will be time consuming and costly, they're not likely to take on nonmeritorious claims."

More recently, and please take note of this, the St. Paul insurance companies have found that in the last 10 years claims are just as frequent in states that cap contingent fees as those that do not. And an American Medical Association Task Force recently concluded that regulating contingent fees "may not reduce the number or severity of suits."

The truth is that it is not the contingent fee that creates large settlements and awards. Those settlements and awards - very rare to begin with - are the result of catastrophic injuries suffered by people who may be totally disabled and may require a lifetime of medical care.

Before closing, let me raise one additional point which in fairness is worthy of an entirely separate inquiry. That concerns the business of insurance - the issues surrounding the cost and availability of liability insurance.

Twice in recent weeks the Association of Trial Lawyers of America has testified before the Congress specifically on those issues and it is not my purpose to repeat that extensive testimony today. But insurance issues are not far from the heart of the present debate and it is argued that one reason to enact this bill to limit rights is the current high cost of liability insurance.

There is no question, Mr. Chairman, that liability insurance today has been made both unavailable and unaffordable to thousands of insureds. The insurance industry, in an effort to justify its conduct (its actions are now telling us that suddenly every American is a bad risk) has blamed the civil justice system for its actions and has advised the American public that unless there are serious cutbacks in the rights of injured citizens to recover damages, insurance will remain unavailable.

There have been several lonely voices in the wilderness, including legislators and lawmakers, that have attempted to inform the public that the problems currently facing the industry are due to its own mismanagement and the underpricing of insurance products.

There is an assumption that the property/casualty insurance industry has been and is in deep financial trouble and that the requested reforms are necessary to preserve an industry that is ill from the ravages of an out-of-control civil justice system.

An additional assumption is that recent premium increases and the unavailability of insurance are also due to the legal system. Both assumptions are completely false. The fact is that for the past several decades the insurance industry has generally done very well. Even in times of heavy underwriting losses due to inadequate premium prices, there were increases in overall assets and an adequate return on net worth. Moreover, it is clear that the insurance industry will do very well indeed in 1986 and that the property/casualty stocks on the stock market have become very attractive investments.

In December 1985, headlines across the country screamed, "Underwriting Losses for Property/Casualty Industry Hit New Highs." The statement was patently deceptive. Although it is true that due to the insurance companies' peculiar accounting methods the industry anticipated an underwriting loss, it is not true that the net profit after taxes would be a loss of 5.5 billion.

The truth and the fact is that for 1985 there should be a 1.7 billion net profit after taxes for the property/casualty industry. This was disclosed by the Insurance Information Institute after Ralph Nader and J. Robert Hunter of the National Insurance Consumers' Organization drew attention to the false predictions for 1985. It is also true that if the estimated \$2.1 billion in policyholder dividends is added back into income the net profit after taxes for 1985 would be \$3.8 billion - a far cry from the claim of a \$5.5 billion loss.

We have produced a sixteen page publication entitled The Insurance Crisis, A Study in Deception which we believe clarifies the mysterious and misunderstood property/casualty insurance practices that permit this wholesale deception of the American insurance buying public. I would be pleased to submit that document for the record.

The simple point regarding insurance that I wish to make today is that because the so-called insurance crisis does not

relate to the functioning of the civil justice system, these wholesale "reforms" that would curtail rights will not impact on insurance premiums.

Let me tell you about a system where already there is a \$100,000 pain and suffering cap, where there are no contingent fees, where there are non-jury trials and virtually no punitive damages other than in intentional torts. That system describes the state of the law in the Canadian province of Ontario and there the headlines scream "Liability Coverage Crunch May Shut Day Care Center" and "Higher Insurance Rates Get School Bus Operators". And there, under that system, the insurance industry has recently refused coverage for school boards, day care centers, ski teams, the city of Toronto, and others and it has raised premiums in some cases several hundred, even one thousand percent.

You want similar evidence regarding problems in this country? The evidence abounds.

In the state of Wisconsin, there is a \$50,000 cap on the liability of any local governmental unit, any city, village or town. That is a total cap, not simply a restraint on pain and suffering awards, a total cap. And until recently the cap had been \$25,000. Well, Mr. Chairman, a few months ago, forty-one local government units in Wisconsin had their insurance completely pulled away. The insurance industry simply said no coverage at any price. In Pennsylvania, where the Political Subdivision Tort Claims Act is perhaps the most restrictive in the country (it outright prohibits many classes of tort suits against local governments) there too we see one of the worst crises of insurance affordability for cities and towns.

The list goes on and on. Restricting rights and capping awards will make this society less just. It will result, ultimately, in products that are less safe and in conduct that is less responsible. But there is no evidence - none - that it will reduce insurance premiums.

Mr. Chairman, the Association of Trial Lawyers of America is willing and indeed anxious to explore fair methods of expediting the litigation process without detracting from individual rights and without sacrificing the right to trial by jury. S. 2046 is not an acceptable starting point.

Senator McCONNELL. I had the opportunity recently to appear on a program called "Strictly Business," with Mr. Broder, and it was rather spirited, and I look forward to hearing from him again.

Mr. Broder.

STATEMENT OF AARON J. BRODER

Mr. BRODER. I want to thank you very much for the invitation to appear here. It is a great privilege. But I would like, Senator McConnell, for you not to be misled by the calculated poison which is disseminated about these large verdicts.

We are supposedly, I guess, the big bad wolves, the lawyers representing the people who have recovered these large verdicts. I could tell you, we have no lupine ancestry, Senator McConnell, and that the truth and the facts about these large verdicts are something which we know about and we would like to talk about.

They are paid only in the smallest fraction, Senator. Some of us are the holders of these record verdicts in America, such as, for example, *Moskowitz v. MIT*, which was a \$10.4 million verdict in New York State, reduced by the Appellate Division to \$5 million, and then further by the general obligations law under which it was finally disposed of for \$2 million. Nobody trumpeted the fact that the case was settled for \$2 million, which was but 20 percent of the verdict, notwithstanding the most grotesque injuries that you could imagine.

The largest verdict in aviation history for a wrongful death in an airline disaster was \$7 million and that was also my case, \$7,010,000 to be exact. I can tell you, however, that while this was the sum announced in the news media, we settled that case for \$2.75 million.

Suits against municipalities, *Vega v. City of New York* was also my case, a \$7 million verdict, for a young paraplegic, settled for \$2 million, Senator, and these are cases where verdicts have been rendered. They are settled for even less money before trial.

Last week I settled a paraplegic case for \$750,000, and I can tell you that \$1 million to \$1.5 million is pretty much the going rate for settling one of these cases in advance of trial.

If you impose your limitation upon conscious pain and suffering, you will take away the bargaining tool from us to even recover the pecuniary loss that these people have sustained. The truth is that we do not recover the full pecuniary loss in most cases of catastrophic injury. The only hope we have to recover that loss is the existence of the threat of the pain and suffering verdict.

If you eliminate that possibility, that exposure, with a lid of \$100,000, you might just as well eliminate the recovery for pain and suffering all together. I can tell you that, with a ceiling of \$100,000 insurance companies will not even offer that amount. It would be silly to do so. They are in business, Senator, and it wouldn't make sense to pay "now" when the most you would have to pay "later" is the same amount.

You must appreciate the fact that the verdict is nothing more than a small bargaining chip in the entire process and that the appellate courts monitor these verdicts, the appellate courts reduce these verdicts and modify them. For you to introduce some kind of

neat formula of a \$100,000 limit will not do substantial justice in each individual case. The only way substantial justice can be done is for each case to be heard separately and for the courts to pass upon the verdict. The judges are no fools. The trial judge is there to pass upon it. The insurance company is there to defend against it, and the appellate courts are there as well to reduce with what is called the device of remittitur, which they do not hesitate to employ.

The increase that we have seen in the cost of premiums, Senator, is directly proportionate to the increase in the slaughter that we have observed over the last decade or so in the air and on the ground, in our factories and in our cities. There is further reason for it which relates to the extraordinary extension of life by modern medicine. For example, a paraplegic now has a normal life expectancy. The young man who suffers a spinal cord severance today will still be suffering in the year 2050. And the one that you referred to, Senator, as a neck injury, was a quadriplegic and they did not pay the \$14 million and the lawyer did not receive that fee you spoke of. That was just a verdict, Senator. It was just a verdict. It was just one of the verdicts trumpeted by the insurance companies, and I beg of you, sir, do not be misled by these verdicts.

You know, we lawyers who handle these individual cases also handle mass disasters, and in handling these mass disasters we learn what the root cause of large premiums is. I am talking about cases such as the MGM fire. Our firm is privileged to be on the committee representing those thousands of people in Bhopal, India, who have sued Union Carbide. We also are on the committee right here in Washington for the Korean Airlines disaster. We have been involved in many of the major disasters, many of the airplane accidents that have occurred this past year and over the last 14 years.

What I have observed with regard to them, Senator, is that the hitch, the glitch, the bug, that stupid mistake which has wrought these mass disasters and which bids fare to ultimately destroy this world is something which has occurred because of inadequate standards, very poor codes and standards—safety standards which aren't anything more than profit standards, whether they be of General Motors in Detroit or Guardsman Elevator in the Bronx, a borough which has the worst elevators in the city of New York—and I suggest you do not try to get on any of them, Senator, you may never get off.

What I say to you, sir, is that you should focus your great wisdom upon the real core issue, the central issue, which is negligence, common everyday garden variety negligence which can be avoided by the imposition of higher standards of care in America.

See to it, Senator, before nightfall tonight that we introduce a law providing for airbags in every car, in the front for the driver and the passenger and the people in the back, and you will eliminate a vast percentage of the catastrophic injuries in America, Senator. Just do that alone and you will reduce insurance premiums for most of us. Thank you.

[The prepared statement of Mr. Broder follows:]

STATEMENT OF AARON J. BRODER, ESQ.*
TO THE COMMITTEE ON THE JUDICIARY, U.S. SENATE ON
S. 2046 - THE LITIGATION ABUSE REFORM ACT

This paper will address itself to the bill of Senator Mitchell McConnell under the misnomer, "The Litigation Abuse Reform Act of 1986" pending in the Senate as S. 2046. "Abuse" is a word of art for Senator McConnell; by it he includes any award in a tort case which for pain and suffering exceeds \$100,000. The bill is presented with glittering generalities about how terribly immoral it is for Americans to litigate as they do and with vague forebodings about the economic effect of tort lawsuits on the national economy. Aside from setting a cap on pain and suffering awards in Federal courts, it also imposes a special Federal sliding scale on contingent fees, which go down to as little as 10% for any part of any award above \$200,000.

The "litigation abuse" shibboleth is an appeal to two political forces, the obvious one being the insurance industry, a very powerful lobby. The second political force is a diffuse but influential group of businessmen and corporate attorneys who believe that Americans who have suffered serious physical injury at the hands of negligent manufacturers, common carriers or physicians do not belong in the Federal courts.

What kind of rhetoric is Mr. McConnell bringing to the halls of Congress? Here is a sample:

A gymnast in California is awarded \$14.7 million after suffering a neck injury in a gymnastics accident. Who paid? The company that made the gym mat, on the theory that the company failed to warn the man of the potential danger. Of the damages awarded, \$4 million was solely for pain and suffering. I repeat, solely for pain and suffering.

This discussion avoids its own obvious implication: that of the award in this case, \$10.7 million was not for pain and suffering, but for what must have been truly catastrophic "economic" injuries. In other words, even the frugal Senator, had he been rendering a verdict in that case and applying his own rule of law, would have had to allow that much for the victim. What Mr. McConnell glibly calls a "neck injury", which could apply to a

* See Curriculum Vitae attached.

passing sprain, might actually have been quadriplegia, or at any rate injury of that order. He throws the \$14.7 million figure at us, with all its zeroes, but neglects to mention that it may represent a structured settlement--of which more later, since the provisions of Mr. McConnell's bill show that he is no stranger to structured settlements--and consequently a much lower figure when reduced to present value. We're not told a word about the history of the product, or about whether a long line of other catastrophic injuries were incurred in its use. Mr. McConnell says that damages were awarded, but he doesn't say explicitly that the \$14.7 million was the last figure in the case. It could have been a jury verdict taken up for subsequent appeal and reduced after examination in the appellate courts. The language seems designed to mislead Mr. McConnell's fellow legislators, and when the time comes for them to consider his bill, we hope that those among them who don't yet know about tort litigation will by then be ready, willing, and able to take these considerations into account in passing on the issue.

Congressmen have been known to travel far and wide in their investigative capacity to learn the truth about the circumstances under which they legislate. We are no longer surprised to read that members of Congress are travelling to the Far or Middle East or Central America. Indeed, some cynical voters and taxpayers have been led to conclude that not all of these trips were absolutely necessary, and were unkind enough to refer to some of them as "junkets". Well, we could propose an itinerary for a completely legitimate junket, one that would open the eyes of Congress to the facts behind Mr. McConnell's bland generalities.

Pain and suffering. Those are two little words which seem little because most people automatically and naturally turn away from them and ignore their implications. The first step in our junket would be a "day in the life" video presentation of a quadriplegia case, or, even better, if it could be arranged, an actual visit to a quadriplegic by the committee members having charge of this legislation. Probably if a Senator hears this

suggestion his mind will automatically begin to propose excuses why it's not practical. And that in itself shows why the experience would be important. We are so constructed that we will do anything we reasonably can to avoid feeling pain and suffering, even only for a few hours, and vicariously. But the pain and suffering which a Senator can avoid by saying that he has a quorum call is a cell in which a quadriplegic is manacled and chained for life. Before he stands up on the Senate floor to vote a standard national valuation for pain and suffering, the Senator should learn in some detail what he is talking about.

The next stop on this junket might be the Burn Unit at New York Hospital. Of course not all tort plaintiffs are burn victims, but some are, and the experiences in this ward would give the Senators a standard definition of "pain and suffering" to refer to. They could look directly into a patient's face and see what it's like when the patient's skin, including that of his eyes, nose, and ears, in addition to other parts of the body, has been literally burned away. They could listen to the music that is played in the tanks where the technicians remove the dead skin and muscle left by the flame. The music is played in a pathetic attempt to drown out the horrible sounds of people screaming. The Senators should look carefully at the green dead areas of the skin while they are pulled away and cut with scissors and razors so that the technicians can reach and identify the part of the flesh that isn't dead. They know that they have succeeded when they can conclude from the cries of the patient that they are cutting live nerves.

The Senators will observe that the technicians do not stop until the patient begins to scream. There is no choice--this must be done--this is the help that is required. The patients are in the tank every day for hours, and their bodies shake for hours after they have been brought back to their rooms. Wet bandages are then placed over the infected area, and when the bandages dry, they are ripped off, and in that way the green stuff is removed and the infection is kept from spreading. The patient has to be held down because of the intense pain. Here is another patient, similarly afflicted, but at a later stage of treatment. He is

sealed into a frightfully tight and painful full body and face mask called a "jobst", which is placed on the patient to put pressure on the burned areas in order to reduce the growth of scar tissue. The patient has to wear a Watusi collar and an adjustable mouth stretcher. The Watusi collar is used to prevent the head from being pulled down to the chest by the powerful scar tissue on the neck.

Next on the junket would be a visit to several accident or malpractice victims, permanently disabled, and a frank conversation with them about their disabilities. Or perhaps the Senators could return to their committee room and take the testimony of the victims there. The neck injury case which Senator McConnell mentioned could possibly make it by operating an electric sip and puff wheelchair through a straw in his mouth to navigate into the committee room. The Senators would learn that "pain and suffering" does not refer only to physical pain. They would learn how a normal person can be transformed into a pariah, a social outcast, virtually overnight. Children point their fingers at him and stick out their tongues. People stare at him, and when he boards a bus or train the other passengers move over in disgust. More importantly, he is left alone with no one to talk to or to share problems with, unless he has the heroic strength of character that has enabled a few disabled people to resume something like normal social life. A young catastrophe victim today can look forward to living to the year 2050, with loneliness, despair, grief, and misery all along the road, and possibly with the \$100,000 consolation prize generously allowed by Senator McConnell as compensation for all this.

I am beginning to feel a bit like one of Dickens' Christmas ghosts, but like them I must relentlessly convey the members of the Committee to yet one more scene. Perhaps this one will be a little more familiar and congenial to them, especially for those who have been practicing attorneys. We are in the courtroom now where the bargaining processes are taking place and the attorneys are dickering over the facts of the case with a view to reaching a possible settlement. This moment is as crucial for the future of the plaintiff as the jury deliberations later will

be if no settlement is made. Those who have followed the post-settlement histories of paraplegics and quadriplegics know that the plaintiff does not take off for Rio after the settlement. Money and large amounts of it are needed just for his survival with some degree of dignity. Whether the money he spends comes out of a settlement or a verdict, and whether it is characterized as "pain and suffering" or no, most of it is going to be spent on staggering medical bills. The life expectancies of the grievously wounded, and the sophistication and expense of their treatment, have increased on the same exponential curve that represents scientific progress. When plaintiff's counsel asks the insurance carrier or the jury for "pain and suffering", he is not in fact asking for a lifetime allowance to be spent on cakes and ale. He is asking for the economic cushion which he knows his client will need decades down the road, when judge, jury, and counsel alike may all be dust, but the client is still trying to figure out how to pay for a car that will accommodate his wheelchair. It should be remembered also that either in a settlement or a verdict what Senator McConnell is pleased to acknowledge as economic injuries may be compromised in the advocacy process. There is no rule of law that either requires or enables a jury or the parties to guess right about the plaintiff's future needs, and not every settlement or verdict errs on the side of generosity.

"Pain and suffering" represent an important chip in the bargaining process. They give the injured plaintiff needed leverage in working out his financial future with the insurer. A \$100,000 maximum is not much of a chip. Since that will be the ceiling on pain and suffering in cases to which the Senator's bill will apply, the insurer's response to a \$100,000 offer from the plaintiff--a trivial figure in major cases under today's law--would be the traditional "you're buying yourself an appeal" argument. With a \$100,000 maximum liability and the possibility that he might do better on that issue, and perhaps whittle away at the plaintiff's case in other ways, every insurer is going to want to go to a trial that can't do him much harm and might do him a lot of good. In considering the foregoing, the \$100,000 cap pushes the plaintiff towards the point where the law of diminish-

ing returns makes it impractical for him to argue the pain and suffering issue at all. That, no doubt, is exactly what the bill is intended to effect.

We have looked at where the plaintiff is coming from in this negotiation; where is the insurer coming from? The rhetoric with which Senator McConnell has been infecting the Senate chamber, the references to "the crisis of 'hyperlexis'", to the "passionate love affair with the courts" which our Constitution imprudently establishes for our citizens, to a "crisis of confidence...in our court system [and] in our legal profession", to the "fabulously wealthy...elite plaintiff's bar", and so on, is not particularly original. It is the same type of rhetoric with which the insurance industry has flooded the country for decades. The Coalition for Consumer Rights, an association which has made it its business to monitor the insurance industry on this issue, challenges the insurance industry on the alleged "crisis":

The "litigious society" is a myth. A recent international survey, published in the prestigious U.C.L.A. Law Review, found that Americans are no more or less likely to bring civil suits than the citizens of most other industrialized nations.

Medical malpractice is usually presented as Exhibit A in the argument that we are a litigious society. But the facts paint a different picture:

- A 1983 study by the Rand Corporation found that medical malpractice claims have increased at an average annual rate of less than 3.5 percent for the last ten years.

- A survey conducted by the U.S. Bureau of the Census found that between 1981 and 1984, malpractice jury awards increased at an annual average rate of 3.9 percent--while health care costs increased at an annual average rate of 11.8 percent.

- The Rand Corporation also estimated that fewer than one in 10 cases of medic. malpractice in the U.S. result in legal claims and fewer than half of those claims are paid.**

The thrust of the insurance company rhetoric is that catastrophically injured plaintiffs and their attorneys should

** Coalition for Consumer Rights, The Insurance Crisis (New York: Coalition for Consumer Rights, n.d.), pp. 1-2.

Pitch In and Do Their Bit to make sure that the insurance industry's balance sheet looks good. S. 2046 is an egregious slap at the legal profession, and particularly at the plaintiff's bar. It contains the \$100,000 cap on pain and suffering which we have already discussed. But it also contains several other devices which are intended as windfalls for the defendant.

--Structured settlements. (Proposed 28 U.S.C. @ 2122.) The structured settlement is a device which invites attorneys for the plaintiff to collaborate with defending insurers. The insurer and the attorney set a big settlement figure, giving the attorney for the plaintiff the image of having achieved a remarkable result as well as his fee up front. But the plaintiff gets his part of the settlement doled out over years, losing its investment value, paying through the nose for inflation, and, in some arrangements, foregoing part of the value of the award if he prematurely dies. Under Senator McConnell's bill, any award in excess of \$100,000 (not any pain and suffering award; any total award) must be structured by the court "over a scheduled period of time or over the estimated lifetime of such individual". Unless the court orders otherwise, the bill requires the payments to cease upon the plaintiff's death. There never was a structured settlement that failed to be a windfall for the defendant. This bill institutionalizes these settlements.

--Limitations on contingency fees. (Proposed 28 U.S.C. @ 2125.) In the ordinary case, the bill provides that the attorney be compensated on a sliding scale, allowing the attorney 35% of the first \$50,000 of the award, and sliding down from there to 10% of the part of the award over \$100,000. However, in the multidistrict litigation case or in a class action, if the court determines early in the proceeding that an ultimate award of \$500,000 is "more probable than not", then "the amount of payments to the plaintiff's attorney or attorneys shall not exceed 10 percent of the total amount of the settlement or award, exclusive of interest." In other words, the provision gives the presiding judge the opportunity to decide, more or less as a matter of discretion, whether he thinks the case is an easy shot, and if he does, to penalize the attorneys accordingly. The 10% limit would

of course make the prosecution of large cases much more difficult financially than it is at present.

To add insult to injury, the bill provides that this decision by the judge "shall not be subject to review in any court, by appeal or otherwise, whether by interlocutory motion or upon entry of a final judgment or order."

--"Limitation" on punitive damages. (Proposed 28 U.S.C. @ 2126.) As we know, damages of this nature are seldom awarded in tort and products liability cases. Under the proposed bill, you can "get" punitive damages if you want to--that is, you can plead and prove them according to the special Federal substantive law and standards of proof the Senator has written. However, you can't get the money. The award goes into the United States Treasury "for the use of the Administrative Office of the United States Courts and the Federal Judicial Center." We have a four-letter word for this in New York City. Gall.

--Counsel's liability for excessive costs. (Proposed 28 U.S.C. @ 2127.) This provision discriminates against plaintiff's counsel. In fact, paragraph (b) is invidiously directed only at plaintiff's counsel. If the court finds that plaintiff's counsel initiated the action "without a good faith belief by the attorney initiating the cause of action that there was a reasonable basis in law and in fact for recovery", or if it finds "that the action was initiated merely for purposes of achieving a monetary settlement where there was no reasonable prospect for an award of damages," then plaintiff's counsel can be held personally liable for treble the damages awarded under paragraph (a). This means that any case in which a defendant's verdict is obtained plaintiff's attorney will then confront the possibility of a further mini-trial, with himself as defendant, and with the possibility not only of paying the defendant's costs, but of paying a fat bonus to the defendant over and above his actual costs.

The suggestion in the treble damages provision that the so-called "elite" of the plaintiff's bar has nothing better to do with its professional time than to bring strike suits is

intrinsically absurd. The \$10,000 subject matter jurisdictional minimum of the Federal court and the hurdles imposed by the expensive pleading and discovery provisions in the Federal rules, together with the ordinary costs of mounting a lawsuit, are more than enough deterrents for anyone to bring a "strike suit" in a tort case in Federal court. A client with money to spare can pay an attorney to bring on a law suit as a matter of principle, or just to harass an enemy. But clients who must retain counsel on contingency cannot do this. Their cases are only brought when there clearly is economic damage enough to satisfy the prosecuting attorney, never mind Senator McConnell. The bar is already motivated by economic forces to weed out the weak cases, and it needs no encouragement from the Federal government to do so.

The blatant unfairness of this bill, its cynical erosion of the right to counsel, especially of the right to counsel of the poor and helpless, its toadying to powerful and narrowly selfish interests--all of these considerations, I feel, make this bill unworthy seriously to be entertained in the Congress of the United States. I can't think of any voting constituency in any state of the Union that would support this bill if it were properly explained to its voters, or that would authorize its representative to support it if its voters knew what was going on on the Hill. To vote for it, a legislator would have to be utterly naive about our court system. He would have to be prepared to believe that our juries have no sense, and never have had any, that our judges and appellate courts are asleep on the bench, and that our common law as the courts have been administering it for years is irrelevant to substantial justice--as well as assuming, as this bill does, that all plaintiff's attorneys are dishonest and that all plaintiffs are malingerers. Our courts--including our Federal courts--know that justice can't be punched out identically for each customer like a cookie. It has to be tailor-made to the case, and that takes time, trouble, and expense.

The technical abuses written into this bill are bad enough, but the callous disregard of ordinary humane values that lies behind it I find truly reprehensible. The philosophy

behind the bill exploits the natural but regrettable human tendency to reject the humanity of the helplessly suffering victim. The bill invites us to spurn the severely disabled, the legless, the armless, the sightless, the spastic, the quadriplegic, the paraplegic, the basket case, the grotesquely disfigured. Its clear aim is to make their claims untriable, by making the expense and risk of the litigation unreasonable in comparison with the rewards.

It is regrettable that the Senate of the United States, in which so much of our history has been made, should be the forum for such legislation, but so it has become, and I look to the wisdom and experience of the members of this Senate Judiciary Committee to reject the proposed legislation as soon as they properly can do so.

CURRICULUM VITAE

OF

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Lecturer before various county bar associations, medical societies, law schools and other medical and legal forums and seminars at government, legal and medical institutions

PUBLICATIONS:

Featured columnist, New York Law Journal, "Trial Tactics, Techniques," since 1971 to date

Author, Trial Handbook for New York Lawyers, Lawyer's Co-Operative Publishing Co., 1986

Author, Dealing with Damages in Personal Injury and Wrongful Death Trials, Practising Law Institute

Editor, 6-Volume Bound Edition of Trial Lawyers Quarterly, official publication of New York State Association of Trial Lawyers

Personal Injury Annual - Author, Chapter "Side Lights - Expanding Actionable Torts by Finding Liability," Matthew Bender, Publisher

Personal Injury Annual - Author, Chapter "Cross-Examination of Defendant's Expert," Matthew Bender, Publisher

Examination of Medical Experts, Volume 2, Author, Chapter "Cross-Examination of Medical Witnesses," Matthew Bender, Publisher

Contributing Author, Compensation in Psychiatric Disability And Rehabilitation, edited by Jack J. Leedy, M.D., Chapter XV, "Rehabilitation - A Key to Adequate Recovery in Personal Injury Cases," Charles C. Thomas, Publisher

Senator McCONNELL. Thank you, Mr. Broder.
Mr. Good.

STATEMENT OF NED GOOD

Mr. GOOD. Good morning. Thank you for inviting a lawyer from a small town in Pasadena, CA, to visit with you. You only hear from us on January 1 of each year.

I am a youngster with 34 years in learning my trade as a lawyer and I have had the privilege of sharing and educating for over 20 years in my State bar. My credentials are really that I am a lawyer who likes people and I specialize in representing injured people in major disaster cases, and I am going to the college of practical experience every day because I am learning from clients and people like you.

I share with you and the American public the comments that the egregious case should be focused on, and I want to focus on not just the egregious case which you have illustrated or have talked about, but I want to talk about the egregious sham defense of nondisclosure, concealment, and the running up of defense costs and the refusal to pay. And I bring to you chapter and verse.

Case No. 1, Donna S., a 25-year-old girl who was invited to ride in a several-hundred-thousand-dollar general aviation airplane that was born only 60 hours before this airplane lost both engines in flight as a result of product failure negligence.

Donna S. looks like a charred hotdog that has been left in the bonfire too long. Just a few of what her pictures are like would sear anybody's mind. Donna did not want a lawyer. Donna has \$300,000 in medical expenses so far and it is just the beginning, and I have not talked about the horrors of her pain and suffering.

She communicated through me to the manufacturer of the airplane, to the engine manufacturer, to the maintainer, to the operator, and to the pilot, and she said that as the innocent passenger who is burned horribly and who has \$300,000 in medical so far, and it is just the start, would you please help me pay for some of my expenses.

This accident happened on August 30, 1985. To this date, not \$1 has been offered by way of advance pay to Donna S. for any of her expenses. Why? It is not because this innocent passenger has done anything wrong. It is because all of these defendants are represented by two insurance companies and each one says the other is responsible and they want to pass the buck, and in the course of passing the buck they have forgotten about Donna S., and so Donna S. had to hire, if you will pardon the expression, a collection lawyer—because that is all I am, a collection lawyer when the insurance companies will not pay.

Your bill of a \$100,000 cap on pain and suffering, if passed, would mean that for Donna S.'s life expectancy of the next 50 years, she will be rewarded richly with the gross sum of \$5.47 per day for her pain and her suffering. She will never know what it is like to have a lover put his arms around her back, because no man wants to touch an alligator in the back.

I have not mentioned the searing scars that go from ear to ear inside because she knows she is not normal. Why is it, sir, that we

should not focus on the egregious refusal to pay and the sham defenses? I have sent in this case multiple sets of interrogatories asking each defendant why it happened, and I am met with a series of blanket objections on transactional costs. The insurance companies are running up the cost of the defense of litigation because they would rather pay to hide what happened than to give advance pay to the victim.

They all admit that somebody is at fault, but they want to pass the buck. Your bill will not help eliminate the cause of this accident. A 60-hour-young airplane, flown by an airline transport-rated pilot, properly maintained and inspected 5 hours before and less than 7 days before this accident, on a beautiful clear day, just like outside here today, should not have both engines failed if the airplane is properly designed and properly manufactured.

I would like to see some attention made to the standards that improve quality so that we can have zero defects, rather than these consequences. That is just one case.

The next case is Lisa N. Lisa N. was a young mother, 35 years old—I guess 35 years young—she had two children, age 2 and 7, and a husband starting out in his legal career. Lisa N. drove a 1974 Volvo. This accident happened in 1984, so at least that lawyer and his wife were not too rich, a 10-year-old Volvo.

They used the car for carpooling and taking children back and forth, and on the day in question Lisa N. took the car back to the family car wash to get it bathed. She stopped the car, bought some fuel, drove it forward a few feet and stopped it again, to turn it over to an attendant.

She got out of the car and took her 2-year-old youngster out of the child's seat in the back, and she then went with her two children to pay in advance for the cost of the wash.

A car attendant who was not supposed to drive that car at all got in and he hit the accelerator and he hit it much too hard and he pinned her to a stonewall by the cash register and he shredded her insides. Her child yelled to the strangers, "Is mommie going to die," and both youngsters witnessed what was happening to their mother.

Her mother told a stranger who was holding her head, "Tell my husband I love him and to take care of the children." Ten minutes later he arrived. This accident happened at 3:30 in the afternoon. She was taken by ambulance to the UCLA Hospital where they did everything humanly possible to try to save her, including pumping in about 85 pints of blood. Less than 12 hours later, and to the medical cost of \$26,763, she died. And I am not here to criticize 12 hours of medical care for \$26,763, because I think the quality of life in this country measures and is worth every dollar you can to save a human being.

But on the transactional costs, we filed a lawsuit because nobody on the insurance company side would do anything. On the transactional costs, the insurance defense in their answers to interrogatories was first that the car lurched forward because nobody touched the accelerator, then it shifted to the car lurched forward because somebody stepped on the accelerator. Then it shifted to the seat must have slipped out and was not locked. Then it slipped to some

other defense, and defense after defense after defense had been asserted, it is now coming up on the 2-year anniversary.

The children have had psychological care, a request has been made for some advance pay to help pay the costs and not \$1 offered yet. Why? Because as long as the casualty industry can hold those dollars and invest them, they can make a profit on their money, and if they can slow pay for 4 or 5 years, when they pay it back they have already earned 80 percent of the debt and they pay it back in inflationary cheaper dollars, while the transactional costs continue and they rise and they rise and they rise, and they rise not because of plaintiff lawyers or claimants, they rise because of a frivolous series of sham defenses which nobody has talked about.

Concealment, fraud, and nondisclosure have no place in the legal system, whether it is the claimant or the defense. They do not belong in either side. And if you do anything about the sham claim—and I am a believer that something should be done—there should also be something done about the sham defense that goes on and on and on.

We talk about transactional costs. The police report—and they were not hired by lawyers, these are claimant or insurance lawyers—they found there was nothing wrong with the car right at the scene. The insurance industry hired an expert who investigated the car and a few months afterwards he reported that he found nothing wrong.

But you still get denials to the answers to interrogatories. So, I took the gentleman's deposition last Friday and it was a pleasure to be taught so well by him. First, I got a letter before I got there, and it said, "Dear Mr. Good, we want \$137 an hour"—this is an engineer—"to be deposed, and we want a 4-hour minimum. I don't care how long the job takes, we want a 4-hour minimum, and if we go to your office we want \$110 an hour for travel time, plus mileage."

So, when I took his deposition, I was excited to find out how well he was doing and I asked him what his fees were, because he really was an independent contractor. He billed \$35 an hour to the independent consulting firm that services the insurance industry. They had a markup from \$35 to \$137 an hour to me. That is one of the reasons for the transactional costs, not 1 cent of advance pay.

The third case that I want to illustrate—

Senator McCONNELL. We need to wind it up as quickly as you can.

Mr. GOOD. Let me take 2 minutes, then. The third case is Frances F. I feel sorry for some of the doctors, so when I took the defense doctor's deposition he told me he charged \$475 an hour, and that is on the early pages of his deposition. Transactional costs are heavy when defense doctors charging insurance companies \$475 an hour, they must earn their supper.

The last point is the insurance crisis and rates which I know a little something about personally. I was red lined last year, or black listed, whichever you wish to call it, because as a pilot I could not get insurance any more. Nobody would write me. I have never had an accident.

I finally found a company that would write me. What a favor. My last year's rate had been \$6,515 for my company, and I had

been paying them for years. I never had a claim. "This year, Mr. Good, it will be \$28,000." Well, I did a little shopping and I found a first-class company who sold me the same limits for \$5,123.

As long as the casualty industry has a monopoly, not controlled by the antitrust laws—God forbid they should ever operate the water companies, because you would pay \$100 a glass for every glass of water.

If you want to help America, do one thing, make the insurance companies be accountable to the public like the rest of corporate America. Open up the antitrust laws and make them accountable, but do not do genetic tampering with things that have worked so well in America for so long. Thank you.

Senator McCONNELL. Thank you, Mr. Good. I appreciate your comments.

I want to ask if any of you are in favor of any portion of S. 2046, any of it.

Mr. GOOD. Will I hurt your feelings?

Senator McCONNELL. No; you will not hurt my feelings at all.

Mr. GOOD. Then I have answered your question.

Senator McCONNELL. None of you are in favor of any of the provisions of S. 2046?

Mr. BRODER. I would say that if you are going to levy sanctions against lawyers and do it in an evenhanded approach, then levying sanctions against those insurance companies and their counsel that delay these cases for years and years, drag them out, increase the costs, make it prohibitive to bring the suit by reason of what they do, then I would be prepared under those circumstances to accept sanctions likewise, equal sanctions for plaintiffs with claims that are not meritorious.

But in so doing, let me suggest this to you, that there are very few of those. We lawyers cannot afford to do it. Strike actions are not brought by plaintiffs' tort lawyers. Strike actions are brought by the corporate attorney, not by the plaintiffs' tort bar. The contingent fee makes it impossible for him and he has no interest in that and no part of it.

Senator McCONNELL. But it is safe to say that if it were crafted in such a way that you would do it to be evenhanded, you would not have any problem with—

Mr. BRODER. No, I do not. I do not like your bill because it says treble damages against plaintiffs' lawyers and single damages against defendants' lawyers.

Senator McCONNELL. I understand.

Mr. BRODER. If you would give us an evenhanded bill there, I would accept it.

Senator McCONNELL. Thank you. You make a reasonable argument there.

Mr. PERLMAN. Senator, with regard to that particular section, in many States throughout this country now there are sanctions against attorneys for bringing an obviously frivolous lawsuit, and also I believe for conducting an obviously frivolous defense. They are not enforced as often as they should be.

I would certainly be opposed to any sort of sanctions which would single out the victim's lawyer, which is very rare. The con-

tingency fee prevents most abuses, where there is no such incentive for a defense lawyer.

Senator McCONNELL. Mr. Good, a brief observation about that?

Mr. GOOD. Senator, I want to say that in my State where there are caps in medical malpractice, there are periodic payments, there are many of the things that you are talking about. It has not reduced the number of negligent injuries nor the number of calls that come in every day complaining about careless doctors and not one insurance company has refunded a premium or rolled back or reduced the charge to the doctors who are still being bled by the same insurance companies.

Mr. BRODER. One other point, Senator. Do not eliminate the right to appeal on sanctions. No lawyer, no more than any other individual in our society, should be subject to the tyranny of one single judge. The right of appeal is a basic, inherent part of our democratic society and that must be preserved even for lawyers.

Senator McCONNELL. OK. All right, let me focus on one other aspect of the bill. Is it safe to say that none of you would be willing to support any change in the collateral source rule?

Mr. PERLMAN. Senator, if I might speak to that issue, I would certainly not support a change in the collateral source rule. The person on the street understands how that works, although it is not in a legal context.

If you were to buy life insurance on your own life and someone else wrongfully took your life, would your beneficiaries be able to take a credit for the life insurance premium because you had bought the insurance policy? Would they be able to get a credit for the payment, or should the victim be compensated for their full benefits?

The tort fees seek to be credited by the victim's own insurance benefits and that is mostly what collateral source is.

Senator McCONNELL. I gather that is the view of all of you, that you would not be willing to accept any change in the collateral source rule?

Mr. GOOD. I do not think there is a windfall because a person had concluded to buy his own protection and then gets hurt by someone else, and the problem is if you cut it off at the collateral then the company is going to cancel you around because you have had a claim, even though you were not the fault of the claim.

Mr. BRODER. When you purchase that life insurance, Senator, you did not buy it in order to help the insurance company. You purchased it to protect your family separately and individually in the event that there was not a liability picture, and I think basically that the collateral source rule avoids the situation which your bill presents. Your bill is a boon to the wrongdoer and it is a plague to the innocent.

Senator McCONNELL. OK. Focusing on the victim for a moment, Mr. Good trotted out some pictures and we all talked about those people that were truly injured, who deserve some compensation.

I mentioned in my floor speech the case of the California gymnast, and Mr. Broder has pointed out that the judgment was subsequently reduced. But focusing a minute on the verdict of \$14.7 million, I asked the staff to assume for the sake of discussion that the lawyer in that case got 40 percent, which is not at all uncommon

as a contingency fee arrangement, and that the \$14.7 million had in fact been paid to the plaintiff.

Under the current system, assuming a contingency fee of 40 percent, the plaintiff would have received of the \$14.7 million, \$8,812,000, and the lawyer would have received \$5,880,000, a standard contingency fee arrangement.

Under S. 2046, with the cap on pain and suffering at the level in my bill of \$100,000, the plaintiff would have received \$9,688,000, almost \$1 million more than under the current fee arrangement, and the lawyer \$1,112,000, not exactly a paltry fee. The plaintiff would have received more and the lawyer would have received less, even with the cap on pain and suffering. And I am wondering here, gentlemen, why the reluctance.

I have not advocated the elimination of the contingency fee. I do accept, as Mr. Perlman gave me credit, I do accept the notion that that certainly is for very poor people in particular the key to the courthouse door. But could it not be argued if the plaintiffs' bar is genuinely concerned—and I am not questioning your motives here, but genuinely concerned about the injured victim, could it not be argued that it might be proper to develop a fee arrangement that allows more money to go to the truly injured plaintiff?

And I think the fee schedule in S. 2046 is not exactly going to require plaintiffs' lawyers to work without compensation, and I am wondering if any of you have any reaction to that.

Mr. BRODER. I have, Senator. I have never recovered a million dollar fee, in any given case. It is almost unheard of for a lawyer to really recover \$1 million legal fee in a given personal injury case. I doubt very much that the lawyer out in California recovers anything like the amount that you project.

Senator McCONNELL. Then you would not object to the limitation?

Mr. BRODER. No, no, that is not what is involved. What is involved, Senator, is that if you introduce a limitation as you have suggested, what you are doing is you are doing it across the board and essentially destroying the rights of the most severely injured person because you limit the fee there to 10 percent above \$200,000.

I could tell you that your bill, by your limitation, makes it virtually impossible, with the enormous costs of running a law office to oppose the insurance company, the mammoth insurance company, which can press a button and get 20 investigators out in the middle of the night in order to defend the case, I assure you that what you are dealing with here is costs to a law office that run \$50,000 a week probably at a minimum in the defense of these major cases. I am talking about the regular costs to the law office, of its overhead. A law firm cannot do professional work, Senator, with a 10-percent legal fee above \$200,000, which I think is what you propose.

It is impossible to run his office. He would essentially have to close it. The cases which result in defendants' verdicts time and time again, the cases which result in small verdicts time and time again, absolutely make it prohibitive to interfere with the legal fees that exist. There are fees to attorneys who refer cases to you

for trial, who participate in them. They also participate in the case and do a great deal.

There is the trial lawyer who tries the case perhaps for 6 or 7 weeks or 10 weeks, while his law office has to back him up and deal with the millions upon millions of the insurance industry. He cannot do it.

Senator McCONNELL. OK. The *Bopal* case that you mentioned you were involved in was recently settled for \$350 million and you claim that no lawyer is going to get a fee in excess of \$1 million?

Mr. BRODER. Senator, Justice Keenan, who is the presiding judge, has made it very distinctly clear to the two firms that are represented on the committee—and we are one of those two firms—that we may not—and I repeat, may not—say one word in comment about that. I cannot in anyway discuss the case. I cannot say a word. There is a gag order on it.

Senator McCONNELL. I understand. Let me just repeat the question, and then I am going to go to Senator Simon who may share some of your views about the insurance companies.

Do any of you favor or would you accept with a minimal amount of complaint some change in the contingency fee system that currently exists?

Mr. GOOD. Senator, I know Richard V., who was the trial lawyer who tried the gymnast case for 8 months in trial and had it for 5 years, and I know that it was settled for a significantly lesser sum. If you frankly were to limit contingency fees in cases over \$5 million, it would not bother me at all. It would not bother me at all. But when you start tampering, where do you draw the line as to where you regulate it, and if you put in disincentives to do better, this is the only community in the world then, unlike the sports community, where the more points you make for your team and the better you do for your client, the less you get, you build in a conflict of interest and the real worry is not whether the client is getting enough, because, believe it or not, those numbers that you are assuming do not exist.

In the cases that I have mentioned here, one fee is 20 percent, going up if it goes to trial to 25 percent. One case is 25 percent, and if you have to keep it around it is lower. So the numbers that you are assuming at 40 percent at not real.

Mr. PERLMAN. Senator, could I speak to the—

Senator McCONNELL. Quickly. We have got to get to Senator Simon here and we have got a lot of other witnesses. Suffice to say, you all do not want the contingency fee system currently in existence to be changed?

Mr. PERLMAN. Senator, that is true, the contingency fee system which generally, as you have already acknowledged, stands for the attorney recovering one-third in most cases works out well.

The case that you mentioned, if I might just elaborate briefly on the facts, this young man is a quadriplegic. He was using a gymnastic mat without warning about the dangers.

Senator McCONNELL. If I might interject, I am aware of the facts of the case, but applying the standard for legal fees under S. 2046 to that case, assuming that he had gotten \$14.7 million, bearing in mind that a portion of the \$14.7 million was for pain and suffering, he would have gotten more, the plaintiff would have gotten consid-

erably more under S. 2046 than he would under the current system had the lawyer charged 40 percent, which is not uncommon.

I am going to go to Senator Simon, who has been sitting here patiently for quite some time.

OPENING STATEMENT OF SENATOR PAUL SIMON

Senator SIMON. I thank you and I regret I did not hear the testimony of two of the three of you. Let me just by way of general background say I, like every other member of this body, I am concerned. We are getting horrendous stories. I do not need to go into the details on them.

We have to look for both short-range answers and long-range answers. I hear from the insurance people that the trial lawyers and jury awards and so forth, that is the cause of the blame. I talk to trial lawyers and I hear the insurance companies are the cause of the problem, and I tend to believe that there is a little bit of truth on both sides in this.

I happen to agree with you, Mr. Good, that the McCarren-Ferguson exemption from antitrust laws is completely unjustified and I will be introducing a bill to knock that out and to make clear they can share risk information but they cannot get together and set rates, any more than some competing shoe stores are able to do that.

Second, I tend to think we need some kind of entity in the Federal Government to gather information. We are almost totally reliant on the insurance industry for the data that we are now getting. That is not a desirable situation.

We are, I would add, the only Western Democracy that does not provide Federal control of insurance. We rely on State commissioners, and too often the State commissioners are in fact instruments of the insurance industry, rather than protectors of the public.

Having said all that, I am also looking for answers on the other side of the equation. It is not enough for trial lawyers simply to say we are defending the public, there should not be any changes.

For example, should we not be thinking about some system, a noncourt system to work out some sensible compromises where people can quickly get things resolved, a system that we do not have right now? I am not suggesting that it is going to resolve all the cases. I am not suggesting that we take away the right to litigation, but we should try and find some sensible answers that protect the public, protect the insurance companies, protect lawyers, and protect everybody.

Beyond that, what should we be doing to discourage those occasional awards that are really beyond common sense? Now, let me toss this open to the three of you.

Mr. PERLMAN. Senator Simon, let me speak to your question first. I think I am the one whose comments you missed, if I am not mistaken, and I—

Senator SIMON. Both yours and the gentleman to your left.

Mr. PERLMAN. Yes, sir. I am Peter Perlman, and I am the president of the Association of Trial Lawyers of America. First, I want to commend your observations about the need to eliminate the McCarren-Ferguson exemption, also the great need for information,

that we are in many respects proposing by anecdote rather than by fact or substantiated fact.

With reference to the alternatives to litigation, let me state that we on behalf of the Association of Trial Lawyers of America, we have joined in that effort. In fact, last spring at this time we sponsored a major conference on alternative dispute resolution to address the problems which can be dealt with, because 19 out of 20 people do not get their cases heard, they do not reach the magnitude that a lawyer can afford to handle those cases, and they are not sufficient damages but they are still wronged and they deserve to be dealt with by the justice system.

There are various devices, mediation, arbitration, minitrials, summary jury trials, all of which can help the problem and to bring people within the justice system.

The only thing that I would oppose would be any limitation on the right of either party, whether it be the victim or the loser, to be able to go to a jury in the event that whatever the alternative dispute resolution was not satisfactory.

Senator SIMON. I would not differ with you on that. Do you have a specific recommendation as to what we do, how we go about this informal process, if I can call it that?

Mr. PERLMAN. Senator, I do not have one today. There have been so many groups that have studied the alternative dispute resolution. We are a willing participant to the entire dialog and we suggest that the Federal Government look into it.

Senator McCONNELL. Senator, if I may interject, I also have a bill in on ADR, S. 2038, which I commend to your attention.

Senator SIMON. All right. Could I ask that you not only ask the Federal Government to look into it, but that we put this on your back?

Mr. PERLMAN. Yes.

Senator SIMON. How about the American Trial Lawyers Association coming in with a specific recommendation on how we deal with it?

Mr. PERLMAN. That is a fair statement, Senator, and we will do that.

Senator SIMON. OK.

Mr. GOOD. Senator, in answering two of your points on alternate resolutions, we in California—and we are no better or worse than anybody else—we have retired judges who serve, if you will pardon the expression, called rent a judge, and we also have some forms of arbitration. Part of the problem is that if the casualty industry is not happy with the awards they give, we have then a second trial, a de novo, so to speak, so the result is the transactional cost becomes twice, rather than once, and in my State, surprising as it may sound to you, in about 98 percent of the cases it is the casualty industry who is asking for the juries because they know if they are tried nonjudge, the plaintiff is going to get the award and get it quicker and get it less.

With reference to the so-called runaway award case, which certainly shocks everybody when you look at it in the newspaper, there are a couple of things that one ought to focus on. The ingredients in the huge case are three things: Huge medical expenses, huge lost earnings, and huge pain and suffering.

In most of the cases involving brain damage, quad, and other devastating injuries, no matter what you ask a jury for and no matter how large the award is, it is usually relatively small, not more than 15 or 20 percent for the noneconomic losses, an 80 to 85 percent return, what the economists have blackboarded as the cost to give a quality of life and to replace the losses.

As long as we have medical costs—and I do not fault what they are, but as long as we have \$26,763 for less than 1 day's hospital care, as long as we have the medical costs, with inflation running, if you want to give a quality of life, it costs a lot of money. If you could reduce the medical costs legitimately and still give quality, if you could find some way of replacing the economic losses for lost earning capacity, because every American today in their life expectancy, after reduction of present value, will make approximately \$1 million, you can reduce the awards. You will not reduce them by replacing the losses, however.

Senator SIMON. Of course, if someone were here from the medical profession, they would say one of the great ways to reduce those medical costs is to reduce the liability insurance costs.

Mr. GOOD. There is another way, and it is easier, just kill all the lawyers and kill all the victims and you do not have any claims, but you are not solving the problem. We have not addressed the issue, if I may, sir, on the medical situation, we do not have enough medical schools so that the 3.5 or 3.75 youngsters who want to go to medical school can get in. You are lucky if you can get into a medical school in this country. We only take a couple hundred at each school.

The medical costs, even if the insurance was free, even if you could not sue a doctor, it would not stop the underlying problem of professional carelessness that causes terrible problems.

Senator SIMON. OK. But what I am still looking for, if I may—

Mr. BRODER. You are looking for solutions.

Senator SIMON. I am looking for solutions, that is exactly right.

Mr. BRODER. The solution that I have—

Senator SIMON. If I may just pinpoint your colleague for a moment here before we move on to you. You mentioned your State. I remember the VISTA Program in the San Francisco area had some informal procedures where people who had problems went in, instead of going into court, to have them resolved. If you owed the local Sears store \$300, you came in and you got it resolved.

It seems to me there are patterns in California and elsewhere that we can find, but beyond that, if I may ask Mr. Good, what do you suggest in a positive way? All of a sudden you are a Member of the U.S. Senate—do not wish this upon you, but if you were a Member and were faced with all these people—service stations who are forced to go out of business, people with astronomical increases in insurance costs—one business in my State had an increase from \$125,000 last year to \$5.3 million. That is just unbelievable growth. What do we do? What do we do, outside of working on the insurance side? I agree, we have got to work on that side, too. What do we do to reduce the cost of litigation?

Mr. GOOD. The first thing I would do is what you propose. I would get the hard facts and find out whether the pricing is because OPEC is saying we will charge what we want to the insur-

ance industry, or whether there are underlying costs that demand that kind of a rate return. Get the facts first. Get them by looking at the books, not having the fox tell you how well he is guarding the chicken coop.

Second, I believe that we should encourage in all of the legal systems in all of the States what is known as offers to compromise by both sides, so that you can make an early request for settlement, and the party who improperly rejects a reasonable offer, whether it be the defendant rejecting the plaintiff or the plaintiff rejecting the defendant, have some economic consequences if they are stonewalling either the claim or the defense.

I think mandatory settlement conferences, if they are in the judicial system, do not belong 5 years downstream, they need case management when it comes in the front door early so you can weed out those cases that literally belong in traffic court or no court from those cases that warrant the full emergency room treatment of a major legal center or major hospital.

Senator SIMON. OK.

Mr. GOOD. And voluntary settlements using, and they ought to be using more referees, retired judges, and people with getting the parties together early and take the profit out of delay.

Senator SIMON. I am intrigued by your first point. You stated we should urge the parties to get together, possibly a mandatory meeting in an attempt to resolve a dispute, and if either party is capriciously not responding, then there is a penalty. Could you send me a letter outlining very specifically what you would like to see?

Mr. GOOD. Yes, sir.

Senator SIMON. Thank you.

Mr. BRODER. I certainly would support that, and I would support substantial sanctions against plaintiffs as well as defendants, and that is the important thing, the evenhanded approach to this so that defendants who are delaying these settlements should be responsible for substantial sanctions and plaintiffs who ask for exorbitant sums in settlement but jury verdicts results in minimal sums should likewise suffer sanctions. I am in agreement with regard to that.

I would like to suggest one other practical approach, and that is what we had in the New York State Association of Trial Lawyers when I was president of that body some 20 years ago. We had a marvelous thing called the masters plan in which the attorneys themselves participated as masters to assist in the disposition of cases. There was a tremendous voluntary participation in that, and I could tell you that the lawyers came home at the end of the day and they would brag about how many cases they settled. They were just delighted to be able to do it. One would say we settled three out of five cases, one four out of five, the other would say five out of five, and one six out of five, because he settled one case that was not on his calendar. He was just enthusiastic about doing that.

I think lawyers would be privileged to serve in that capacity and that if we were to utilize that manpower we could also help a great deal in calendar congestion.

Senator SIMON. Thank you. Thank you, Mr. Chairman.

[The prepared statement of Senator Simon follows:]

PREPARED STATEMENT OF SENATOR PAUL SIMON

The insurance crisis that currently confronts and confounds this nation is most serious and extremely perplexing. This crisis cuts across virtually every sector of the economy and has rapidly developed into the number one problem of interstate commerce.

Business owners, public entity officials, and professionals of all stripes are appealing to Congress with increasing urgency for relief from skyrocketing insurance premiums.

This crisis defies facile analysis and the "quick fix." Insurance industry spokesmen say the price increases are necessary largely because of excessive litigation and multi-million dollar settlements. They are calling for changes in the nation's tort laws.

Others contend that the insurers are themselves responsible for the situation. These parties say insurance companies are raising rates to recoup losses resulting from artificially low premiums in the early 1980s, and that this huge, socially and economically important industry needs tighter regulation.

What role and what actions may be called for Federally are, as yet, unclear, because tort law and insurance regulation generally are within the jurisdiction of the States. Many of the States are attempting to address the insurance crisis administratively and legislatively—but, it is charged that they are moving too slowly, not far enough, and that the possible "mish-mash" of State reforms may need to be sorted out and ordered Federally.

As I assess this distressing situation it seems to me that we need both a short-term strategy and a longer-range one. As a first priority, we must move with deliberation to do all possible to alleviate the intense problems of liability insurance availability and affordability that are wreaking havoc on the lives and livelihoods of our constituents. For the long term, we must "dig in" and "hunker down" for what will necessarily be a lengthy process of education, examination and debate, as we focus on the structural problems of both the insurance industry; its organization, operation and regulation, and the distortions and abuses of our civil justice system that have, in large measure, driven this crisis.

Mr. Chairman, we must commit and dedicate ourselves to the painful process of sorting out these issues. We cannot, as a nation, stand helplessly by, captive to grotesquely exaggerated and disruptive insurance market cycle fluctuations. We can and must change the structural equations of the insurance business and the tort system; but first, we must have a better understanding of the complexities and the implications of these equations. That is why I welcome these hearings, Mr. Chairman, and I commend you for your interest, dedication, and efforts as we wrestle with these most critical considerations.

Senator McCONNELL. Thank you very much, gentlemen. We appreciate your coming.

Mr. GOOD. Thank you.

Mr. BRODER. Thank you.

Mr. PERLMAN. Thank you, Mr. Chairman.

Senator McCONNELL. Senator Specter was here briefly and asked that some questions be submitted to some of the witnesses in writing and those will be included in the record.

Senator Symms has a statement which he would like to appear in the record and, without objection, that will be done.

[The statement of Senator Symms follows:]

PREPARED STATEMENT OF HON. STEVE SYMMS, A U.S. SENATOR FROM THE STATE OF IDAHO

Mr. Chairman, thank you for allowing me a few minutes this morning to address the Committee. I want to comment only briefly on the liability insurance problem in general and on the legislation Senator McConnell has introduced to help alleviate the problem.

INSURANCE CRISIS

I am pleased you're holding this hearing to draw the Senate's attention to this very serious problem. The liability insurance crisis affects nearly every segment of our society. Businesses, manufacturers, governmental entities, and many individuals

must carry liability insurance to avoid some of the financial risks associated with their day-to-day operations. In many instances, liability coverage is required by law. Yet, today that insurance is often either unavailable or unaffordable.

In my State of Idaho, we have unpaid mayors and city councilmembers who have been forced to resign because the city could not afford liability coverage. We have small business owners, trucking firms, day-care centers, and professionals (from accountants to architects to nurse-midwives) all of whom have been hard hit by tremendous premium increases and sometimes the complete lack of available insurance coverage. It is a very serious problem for my constituents.

I know that people disagree about the factors giving rise to this situation. Some contend that the insurance industry is gouging the American public with exorbitantly high premiums to make up for poor investments and unreasonable price wars of past years. Others blame the problem on the greed of trial attorneys who supposedly seek out injured people and encourage them to file damage suits in which the attorneys stand to make thousands of dollars in contingency fees.

I, for one, don't believe the root of the insurance problem lies in either of these two arguments. Rather, I believe the main problem is our society's increasing tendency to sue as a means of avoiding risk for the actions that we take.

It seems that many individuals and the courts are either unwilling or unable to assign "guilt" in cases of negligence. And in an effort to avoid this responsibility, individuals file damage suits even when they are almost solely to blame for the injuries they've suffered, and courts assign fiscal responsibility to the party with the deepest pockets, even when that party's negligence is an insignificant factor in assigning fault for the injury.

TORT REFORM

One means to redress this problem is to reform our state and federal tort laws. I am pleased that the Administration's Tort Policy Working Group has recently issued its report on the causes, extent, and policy implications of the liability insurance crisis. The report includes several specific recommendations which I believe we should consider seriously as Congress reviews Federal tort law.

The panel recommends a reasonable cap on noneconomic damage awards, the retention of fault as the basis for liability awards, the elimination of "joint and several liability," the payment of large economic damage awards over time rather than in one lump sum, and the elimination of the collateral source rule.

To your credit, Senator McConnell, several of these recommendations had already been incorporated in S. 2046. I want to thank you for introducing that bill and for your continuing efforts to bring this insurance problem to the attention of the Senate.

If this hearing leads to action on S. 2046, I hope that you and the other members of the Committee will see fit to add a provision which addresses the doctrine of joint and several liability.

Finally, while both S. 2046 and the Tort Policy Working Group propose to cap contingency fees, it is this Senator's belief that the government should refrain from trying to regulate fee arrangements negotiated between attorneys and their clients. There are other and far more desirable ways to address the insurance problem.

Again, Senator McConnell, I thank you for your perseverance on this issue. If we can make reasonable reforms in federal tort law, all of us who are consumers will owe you a debt of gratitude.

Senator McConnell. Our next set of witnesses from the insurance industry, I would like to call them as a panel, Lowell Beck, who is president of the National Association of Independent Insurers; Franklin W. Nutter, president of the Alliance of American Insurers; Thomas S. Chittenden, senior vice president and general counsel of the American Insurance Association; and William McCormick, who is the chairman and chief executive officer of the Fireman's Fund Insurance Co.

Gentlemen, we are running considerably behind and I would like for each of you to summarize your remarks, and we are going to begin with Mr. McCormick.

Senator Simon. Mr. Chairman, it occurs to me that we are hearing from the trial lawyers, and we are hearing from the insurers,

but we are not hearing from the consumer groups. At some future hearing are we going to do that?

Senator McCONNELL. The first hearing, at which I think you stopped by, we had the fellow here from Mr. Nader's organization who said that he was representing consumers and made a very persuasive case on their behalf, and we are certainly happy to hear from some more if you have some in mind.

Senator SIMON. OK.

Senator McCONNELL. Mr. McCormick.

STATEMENT OF WILLIAM M. McCORMICK, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FIREMAN'S FUND INSURANCE CO.; LOWELL R. BECK, PRESIDENT, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS; FRANKLIN W. NUTTER, PRESIDENT, ALLIANCE OF AMERICAN INSURERS; AND THOMAS S. CHITTENDEN, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, AMERICAN INSURANCE ASSOCIATION

Mr. McCORMICK. Mr. Chairman, I am Bill McCormick, CEO of Fireman's Fund Insurance Co. I am a relative newcomer to the insurance industry. I got involved 2 years ago. I used to be president of the part of American Express that ran the American Express Card, American Express Travel Related Services Co. Inc., and I got involved with insurance when Fireman's Fund in particular and the insurance industry in general got into serious trouble.

I would like to start my remarks by picking up on a comment Mr. Broder made when he talked about how quickly they were able to settle cases 20 years ago when he was head of the New York Trial Lawyers Association. I feel he touched exactly on what we believe is the root cause or at least one of the root causes of the current liability crisis: 20 years ago our legal system was very different than it is today.

Our legal tort system in America grew out of English common law. In 1776, we shared the same legal system as England and, surprisingly enough, in the year 1960, almost 200 years later, our legal system and England's legal system were very similar, even though our American courts had set precedents and modified the law slowly over time during that intervening period.

Starting in about 1960 and over the last 25 years, our tort system has gone through an almost total metamorphosis. It has changed enormously.

The concept of fault has been changed. The English common law demands a fairly high standard or tough definition of fault. It really has to be negligence and it has to be the real fault of the defendant or the wrongdoer. We have watered that down in our legal system and today the definition of fault and the definitions required to establish liability for negligence are far weaker and therefore more people are now found guilty.

The concept of sovereign immunity was eliminated in the early sixties. The concept of pain and suffering damages in English common law are only allowed when they are accompanied by a physical injury. Most of the examples given here this morning dealt with pain and suffering that was associated with a physical injury and that is perfectly acceptable under common law and

common sense. It is the pain and suffering that comes when there is no physical injury that starts to go beyond the pale.

So what we are talking about in America is not a legal system which has served us well for 200 years, we are talking about a legal system which has been totally revolutionized in the last 25 years and is therefore, very different today. We believe that the pendulum of justice has swung too far, to the point where the burden is now on all of us. We can all very easily be made victims by our legal system if, in fact, we have money or access to money through insurance.

So I would like to endorse the line of leadership and thinking that you, Senator McConnell, and the committee are showing by trying to understand what has happened.

There is a tort liability crisis in this country. There is also a general liability crisis in this country, and the two are different. The tort crisis is driven by the changes in the law which have led to a lesser definition of fault, larger judgments, increased costs, increased prices, reduced insurance availability, and a tendency among the entire society to talk in terms of lawsuit.

Even children, if you listen on the playground, no longer say I am going to tell my mommy or daddy, they say I am going to sue, and that is illustrative of what is happening.

Now, I have been very careful and we have been very careful in Fireman's Fund not to lay the blame at the foot of the trial lawyers or the courts or the insurance companies. This revolution in our legal system is part of a cultural shift of attitudes toward entitlement.

Our job today is to decide if we like these changes, if they are healthy for our society, if we should make some adjustments. We think that some adjustments are required.

Ralph Waldo Emerson, in his wonderful essay on compensations made a very perceptive comment: "Everything has a price." Today there is a price for these enormous awards that are being won by the few who litigate. That price is found in the tax and/or the prices that are paid by the many, which have grown enormously, to pay for the few who win awards.

A fifth of the cost of a stepladder goes to cover the product liability. Why? Somebody climbs up and they fall down and they blame the stepladder. Somebody does a very difficult gymnastic maneuver and falls on their head—granted they are injured—Senator McConnell, I would hold that the mat is innocent.

There is one other aspect I think I must touch on, because the insurance industry is not guiltless in this process, in this problem. What I call the sociolegal inflation costs of liability have been growing, if you use ISO's estimates, something like 13 or 16 percent a year, about twice the rate of pure economic inflation. I think we heard some of the reasons today.

Modern medical care keeps people alive longer. That certainly has been a factor. The legal system has also been a factor: About 5 out of 100 cases are settled in court—the rest are settled on the steps of the courthouse. So these verdicts we hear about are not innocent. The fact that they are cut back in the appeals court is not so important. It is the fact that when those verdicts are announced, that becomes the fuel to the fire for the pressures on people to

settle. In fact, there is a trial lawyer in Los Angeles who was quoted as saying that because everyone is afraid to go to court because they cannot predict the settlements, that he can settle a \$10,000 claim for \$100,000 because people are frightened of going to court.

Now, we have tried to take a cut at what is the cost of some of these changes and, granted, there are many factors mixed in. It is probably impossible to measure the cost of the tort system. But we have looked at premises liability. Premises liability is a line of insurance which says if you slip on the sidewalk or fall down the stairs or otherwise injure yourself in someone's property, then you can sue. It is a fairly tame line of liability insurance and we selected it because it eliminated some of the variables in trying to understand what was happening.

The Insurance Services Office estimates that over the last 10 years the cost of lawsuits in this line of insurance has been growing at 19 percent a year, compared to an economic inflation of something that has averaged closer to 6, and maybe that 6 is a bit high, but that leaves us with a spread of about 13 percent difference between economic inflation and what I would call sociolegal, and socio in this case would include medical costs.

That is an enormous difference. If that difference could be eliminated, if the 19 percent growth rate in those costs could be reduced over the next 4 years to something closer to 8, that would save \$1 billion a year over the 4-year period.

Now, if you could take that same number and apply that approach to the whole of general liability, not just premises liability, that would suggest a savings number against what otherwise we would have to pay, something like \$21 billion over a 4-year period. The numbers are enormous.

Now, how you separate cost of medical from cost of legal is a difficult problem, but there is no question that the sociolegal rate of cost increase is far higher right now than the cost of economic inflation which is coming under control. I think Ronald Reagan has done very well in his administration in getting our economic inflation under control and I think now we have to attack some of these other areas.

I would like now to focus on Senator McConnell's bill. Basically, you are focusing on S. 2046, although we certainly support the line of thinking in S. 2038. You are recommending to enact some general forms of Federal legislation—limit on contingency fees, cap on noneconomic and pain and suffering, reform of some of the punitive damages, and admission of collateral source. We think this is the right line of attack. We think these are things that the entire country should debate. In fact, separately I have recommended that a blue ribbon commission be formed of legal scholars, consumers, lawyers, businessmen, and perhaps some representatives of the insurance industry to try to take a look at this enormous revolution in our laws over the last 25 years. This commission would decide which changes are good and should be maintained, and decide where we went too far and should adjust back. We would like to see that process take place.

I think you should also address joint and several liability and the concept of comparative negligence versus contributory negligence.

Under the doctrine of comparative negligence, a plaintiff, even if he is heavily responsible for his own injury, can get recovery from a defendant. I think that is again a tenet that must be changed.

The conclusion of what I would like to say is that, like it or not, this litigation revolution we are going through is just the tip of the iceberg. This court-made liability crisis which began in the sixties has led to weakened criteria for fault, clogged courts, enormous settlements, and—more dangerous than anything—it has created a societal attitude that someone else is always responsible for an injury.

There was a day when you tripped on the sidewalk, you said, "Darn, how could I be so careless." You then went to your own doctor, got the injury fixed and went on your way. That is no longer the case, and it is being exacerbated by law firms who now advertise openly in every newspaper in the land and say, "Did you trip on a sidewalk? Do you have a claim against the XYZ Company? Come and see us." These types of law firms are machine shops; they just turn out litigation and defendants must go through the process of discovery and/or the fear of the uncertainty of which way the juries will decide. Insurers basically pay tribute to this process.

We do it as well, I am ashamed to admit, because it is not just the cost of court, it is the time involved in testifying and it works as a sort of blackmail. It's like going to traffic court: If you think you are right on a parking fine, how many of you just pay it rather than going to court?

This tort revolution is not just occurring in the tort system. It is happening in workers compensation as well. People are now beginning to say, "Stress on the job made me drink," or "Reading a lot affected my eyesight, I have to wear eyeglasses." If you take this to the extreme of saying that we are not far from the day when people will begin to sue and win for growing old or the normal vicissitudes of life. The Senate and the Congress and the State legislatures and the State courts must stop, stand back and look at the legal system and say something very serious happening here, it is not good for the American society to go further down this path.

Thank you very much, Senator.

[The prepared statement of Mr. McCormick follows:]

TESTIMONY OF

WILLIAM M. McCORMICK
CHAIRMAN AND CEO
FIREMAN'S FUND INSURANCE COMPANY

Mr. Chairman and members of the Committee, thank you for the invitation to appear before you today.

I am Bill McCormick, Chairman and Chief Executive Officer of Fireman's Fund Insurance Company. Although I have spent many years in business, I am a relative newcomer to the insurance industry. Prior to joining Fireman's Fund in 1984, I was President of American Express Travel Related Services Company. I came to Fireman's Fund, which at the time was a subsidiary of American Express, during times of serious financial trouble within Fireman's Fund and the entire industry. I have now been in this business long enough to have developed a good grasp of the issues, yet retain freshness of perspective.

I first want to state that unprofitable businesses cannot survive; I am not ashamed to say that Fireman's Fund expects to make a profit on the services it renders. This is particularly important for insurance companies because they -- like banks and other fiduciary financial institutions -- must protect their financial strength. They must preserve this strength through conservative accounting and regular profitability, otherwise they cannot meet their ultimate requirement: a promise to pay -- usually in the future.

I would like to begin with a few brief observations about the industry. First, insurance is fundamental to a sound American economic system. It is the second largest industry in the country and is essential for commerce and the granting of credit. In the vast majority of cases, credit will not be granted unless underlying insurance exists to protect assets. Quite simply, without insurance, commerce would grind to a halt.

Second, insurance is an extraordinarily competitive and fragmented industry. The industry is comprised of about a thousand companies. Fireman's Fund is the seventh largest property/casualty insurer; yet, we write only 2.5 percent of the industry volume. Historically, because of fierce competition, insurers have earned a relatively low return on equity, averaging 8 percent over the last ten years. The competitive and

cyclical nature of this business causes ROE to fluctuate, but our overall average is far less than that of other industries.

Third, we are in the business of spreading risk, not absorbing it. We play the law of large numbers. In theory, we charge every insured enough to cover the losses of the few. We are not, cannot and will not be in the business of absorbing societal costs we cannot spread. To survive, we must pass these costs on to our insureds in the form of premiums.

Fourth, insurance is a cyclical business. This last cycle, for perspective, was the worst in 50 years. As a result, the recovery you are witnessing is very difficult for both the industry and its insureds.

(EXHIBIT A)

Fifth, and finally, I would like to make a private observation. Insurance is probably not recognized as the best managed industry in America. Having been in it for awhile, however, I would also say insurance is one of the most difficult industries in America to manage. The reason is that costs are so difficult to predict -- and take so long to measure.

You have heard a lot about what has happened in the industry. I would like to take a minute now to give you a real-life picture of what has happened at Fireman's Fund over the last two years:

- o In 1985, Fireman's Fund lost \$44 million.
- o Two years ago, when our losses began, we laid off 1,600 valued employees -- 12 percent of our work force.
- o In the last two years we have added an incremental \$600 million -- 15 percent -- to our reserves.
- o Virtually everyone who was in top management two years ago has been replaced.

I am not proud of what has happened at Fireman's Fund and, frankly, I don't enjoy telling United States Senators about our difficult times. However, I must use these examples to put to rest any irresponsible accusations of collusion among "the good old boy" network of insurance companies. If there has been any pact in our industry, it has been a mutual suicide pact! The pain and bleeding in insurance companies has been real. I also recognize the pain that our needed recovery has caused for others.

Your mail and mine identify the major problems for consumers, businesses and municipalities today: affordability and availability of insurance. While they are separate issues, they are also interrelated. Why? When insurers lose money, they lose surplus and, therefore, capacity to write business. When losses surge, capacity is constrained; we back away from the riskier, long-tail areas of insurance that previously were written. We concentrate on those lines of business that we understand and those where we believe we can spread risk and make a profit. It is at this point that insurers usually stop writing unpredictable, heavy loss lines such as general liability.

Today, most lines insurers write are at, or are approaching, adequate rate levels. These include 88 percent of written premiums: the property lines, worker's compensation, homeowner's insurance (comprising 61 percent of total industry volume); and auto liability, both commercial and personal (comprising 27 percent of industry volume). General and other liability, such as medical malpractice, professional liability, and excess insurance make up the remaining 12 percent; this is where the real problem lies. (EXHIBIT B)

While dramatic, the increases in prices from the low levels of the past price war are only now reaching actuarially sound rates -- rates that offer some hope of profit. The Insurance Services Office advisory rates (rates recommended to cover loss costs and to make a profit for each line of insurance) have increased regularly over the past decade as you would expect. The actual prices charged by the industry did not increase until last year. The industry price competition suppressed actual rates for six years, and they are only now catching up to what is needed, albeit rapidly. (EXHIBIT C)

Based on Fireman's Fund's experience, we believe that about seven percent of the insurance universe falls into what we term the "critical classes." In other words, only seven percent of this \$124 billion industry is experiencing availability problems. Critical classes cross all categories of liability insurance, including municipalities, medical malpractice, product liability, day care centers, and professional liability, such as director's and officer's insurance. (EXHIBIT D)

Why do areas such as these face such problems? To answer that, we must delve into how and why an insurer decides to underwrite a particular risk.

When a request is received for insurance coverage, it is reviewed by an insurance underwriter. The underwriter must analyze the prospective insured in three interrelated environments, each of which has an impact on the potential rate of return. (EXHIBIT E) These environments include:

The Socio-Legal Environment

- Expanding tort theories
- Social inflation
 - Expanding sense of entitlement
 - Increasing size of jury awards
- Potential frequency and severity of loss

The Regulatory Environment

- Freedom of form
- Freedom of rate
- State regulations

The Operating Environment

- Competition, which includes market participation and price
- Economic outlook
- Internal expertise in the particular class or line of business

In the traditional lines of insurance, such as property, all three operating environments weigh about equally. In the more difficult lines, such as general liability, the socio-legal environment plays a much larger role: cost trends of that environment must be projected far into the future when the potential claims will be settled. The rapidly deteriorating trend in the socio-legal environment -- more suits are being filed and the courts are becoming more lenient in defining liability -- has caused this portion of the equation to carry very heavy weight in underwriting decisions. (EXHIBIT F)

The difficult -- or critical -- classes all have one major characteristic in common: They are what we call "long-tail" risks, meaning that we often do not know our losses for many years. Again, I call upon property insurance versus the general liability line to illustrate this point. In the area of property insurance, claims are filed and settled quickly. For example, if a storm hits a home and causes damage to the roof, the owner immediately notices the damage and files a claim, which is then settled. Seventy-two percent of property losses are filed and settled in the first year following policy expiration. By year three, 99 percent of claims are filed and by year four 100 percent of the claims have been resolved.

By contrast, for general liability, only 50 percent of the losses are filed and settled at the end of year four. By year five, that number has reached only 62 percent; by year ten, 94 percent. It is evident that it is difficult to accurately predict the ultimate costs and risks in general liability. (EXHIBIT G)

Quite simply, the longer the tail, the more uncertain the risk. This is analogous to the bond market where long-term bonds carry higher risk and are therefore expected to yield more than short-term bonds. All insurance companies analyze their anticipated profit margin in relation to the amount of risk and make an overall assessment as to how much of each line of business they want to write. EXHIBIT H shows Fireman's Fund's current analysis of the risk and return for various lines of business.

For example, property liability, which has a short tail, also has a low to medium risk factor and now has a medium to high profit margin. Writing property insurance thus represents attractive risk to an insurer. Worker's compensation has a long tail, high risk and low profit margin, making it an unattractive risk at present. General liability has an extremely long tail, very high risk and low profit margin; it does not yet represent a very attractive or even acceptable risk, particularly with tort law trends as they are.

As I said earlier, the socio-legal environment is the most important factor affecting general liability insurance. The expansion of tort

theory and the tendency of courts to find policy coverage where none was intended has caused the actual growth rate in loss costs to be consistently higher and the tail to be consistently longer than originally anticipated. With short-tail lines, a five point error in the forecasted increase in annual loss costs will result in a small, two point change in the loss ratio. On the other hand, in long-tail lines such as general liability, a five point error in the forecasted increase in annual loss costs will result in a 30 point change in the loss ratio. (EXHIBIT I)

Given the unattractive nature of general liability, why and how does a company such as Fireman's Fund decide to write this kind of insurance? We have already discussed the three interrelated environments that determine the corporate evaluation of general liability. We then look to see whether a prospective individual risk represents a better risk than the "typical" general liability risk in the same category. This is done by identifying specific hazards that may cause a loss and by determining how much of the hazard could be reduced through the insured's loss control measures. A price is then applied to the risk assumed based on these classifications. (EXHIBIT J)

The Class Evaluation Matrix (EXHIBIT K) illustrates how Fireman's Fund evaluates a traditional retail grocer, a day care facility and a municipality. You can now understand why, when our capacity is constrained, we would rather take the risk of insuring a grocer than a municipality.

To summarize, the difficulty in forecasting future loss costs combines with the long-tail in general liability to create unusually high risk which is not being compensated by the expectation of a reasonable profit. This difficulty is due to the dominant influence of the socio-legal environment in the form of:

- o expanding theories of tort
- o the finding of insurance coverage when none was intended by the contract
- o higher court awards

- o higher legal defense costs
- o growing societal tendency to sue

Many people have asked: What is the cost of the tort system? While it is almost impossible to measure, we can get some indication of its relative magnitude by examining overall cost trends. The Insurance Services Office has calculated that the increase in severity for premises liability is 13.5 percent. The Organization also agrees that we can conservatively estimate a frequency increase of five percent annually. Therefore, a conservative estimate of the loss cost trend for premises liability would be 19 percent, compared to economic inflation of three to six percent. This would suggest that the difference represents socio-legal inflation, about 13-16 percent, approximately three times the rate of pure economic inflation. (EXHIBIT L) If that growth could be reduced to eight percent annually, much closer to the rate of economic inflation, insureds could save \$1 billion in a four year period compared to what costs would otherwise be for just this one category of insurance. Applying this approach to the entire general liability area would suggest a potential savings, against current projections, of \$21 billion over the same period.

Therefore, to the question of how much liability costs will drop if tort reform is passed, the answer is plenty against what those costs would otherwise be without change, and that's only an estimate! The growth momentum of higher and higher tort costs is rising exponentially. It will take a major change in the law just to slow the rapid rise in liability costs, let alone achieve an absolute reduction from one year to the next.

Suggestions about how to reform the tort litigation system abound. The federal government and each state across America must review its own tort system and initiate appropriate reforms. The thrust must be directed toward fairness and common sense rather than merely entitlement. As I have stated in my speech, "The American Tort System: A Time to Rebalance the Scales of Justice," and our "Citizen's Guide to Tort Reform," legal reforms should focus on achieving the following objectives:

1. Restore the notion of fault/negligence to the system. It is ludicrous that a defendant who is not really at fault can be held responsible for an injury simply because he has money or access to money through insurance. In the area of product liability, for example, plaintiffs need only prove that an injury might have been prevented if the product had been designed differently. The legal doctrine of strict liability has been applied far too broadly.

2. Hold defendants financially responsible only for their degree of fault in an injury. In today's legal environment, under the doctrine of joint and several liability, a person who is only slightly at fault may be held liable for the entire award if other defendants do not have money or insurance. Moreover, the doctrine of comparative negligence should be modified to require that plaintiffs who are more than 51 percent responsible for their own injury should not be rewarded in court.

3. Limit pain and suffering awards. Pain and suffering judgments must be controlled and should be limited in amount and only to situations where an accompanying physical injury exists. Today, people can -- and do -- collect money for mental suffering which results from simply witnessing an accident or from fear of catching an illness. In addition, these non-economic awards should be restricted to some reasonable proportion of the economic loss incurred by the injured party.

4. Eliminate redundant payments for economic loss. Today, because of the collateral source doctrine, defendants cannot introduce evidence to show that a plaintiff has already been partially or fully compensated for a loss through worker's compensation or other health insurance benefits. A first step toward restoring logic to the system would be to allow introduction of this important information as evidence in order to allow the juries to decide whether double or triple compensation is justified.

5. Cut legal defense costs. In many areas of the law, including divorce and other civil justice cases, plaintiffs have found it much faster and cost effective to resolve disputes through arbitration. Lawyers should be required to inform clients of their right to obtain redress through arbitration, which speeds resolution, cuts legal costs

and allows victims to receive a larger portion of the award. In addition, we should consider mandatory arbitration for smaller claims. If the plaintiffs or defendants are not satisfied with the arbitration decision, they should be allowed to pursue the case in a court of law; however, the loser should be held responsible for all legal costs.

6. Reform punitive damages. While the original justification for punitive damages has grown less persuasive, these damages have become increasingly larger and easier to obtain. Today, instead of demanding an injury be "willful and wanton," or that the defendant's conduct be wrongdoing of an outrageous character, many states now permit punitive awards when the defendant's conduct amounts to the equivalent of simple negligence. Punitive damages should also be restricted to a reasonable proportion of the economic loss, and paid to the court, not the plaintiff. Because punitive damages are intended to punish and may be considered criminal in nature, the standard of "guilt beyond a reasonable doubt" should apply.

Senator McConnell, in his proposed Senate Bills S.2038 and S.2046, has substantially covered my recommendations three through six. In addition, his bills specify penalties for bringing nuisance lawsuits, provide limits on contingency fees, and allow periodic payments of large awards. I fully support these additional points, and urge that my first two recommendations be amended into S.2046. When passed, then at least federal law will pass the test of common sense.

Stepping back from insurance, and speaking as an American citizen, I am increasingly concerned about the social costs of litigation in this country. This concern is shared by many. The court-made liability crisis which began in the 1960's has led to weakened criteria for fault, clogged courts and enormous settlements, and is fast making us all potential victims: individuals, businesses and governments. The real explosion, however, is just beginning.

Today's liability crisis is the tip of the iceberg; the litigation trend is growing exponentially. While there are some short-term problems of high rates and unavailability of coverage, insurance problems are only the symptoms we see, not the root problem. Like a mirror, insurance

reflects the shape of society -- a shape which has been distorted by a quarter century of court-made legal changes. Now all of society knows the door to the litigation vault is open. "I will sue you," has become very much part of our everyday vocabulary -- for children as well as adults. The momentum is frightening. People are now suing their employers -- and winning -- saying work made me: need eyeglasses, become an alcoholic, develop stress, have a heart attack -- when, in many cases they are suing simply for old age!

Needless to say, the increase in tort litigation presents a serious problem for our country; one that must be resolved in the interests of all the people. In my view, the pendulum of tort justice has swung too far, the societal costs to the many outweigh the huge settlements won by the few. We as a country need to decide what laws are best. That is why I have been recommending establishment of a Blue Ribbon Commission of legal scholars, lawyers, judges, government officials and business leaders to comprehensively define the legal changes needed.

The legal changes proposed by Senator McConnell as amended above, if enacted, will go a long way toward righting the balance for federal courts. States must do the same. Once our tort laws are right, known and predictable, our economy will readily adjust.

Finally, I would like to commend the Chairman, Senator McConnell and all members of the Senate Judiciary Committee for their leadership on this most important issue for our country.

EXHIBIT A

THIRTY-ONE YEAR STUDY

ALL STOCK PROPERTY/CASUALTY COMPANIES IN USA

UNDERWRITING: PROFIT/LOSS

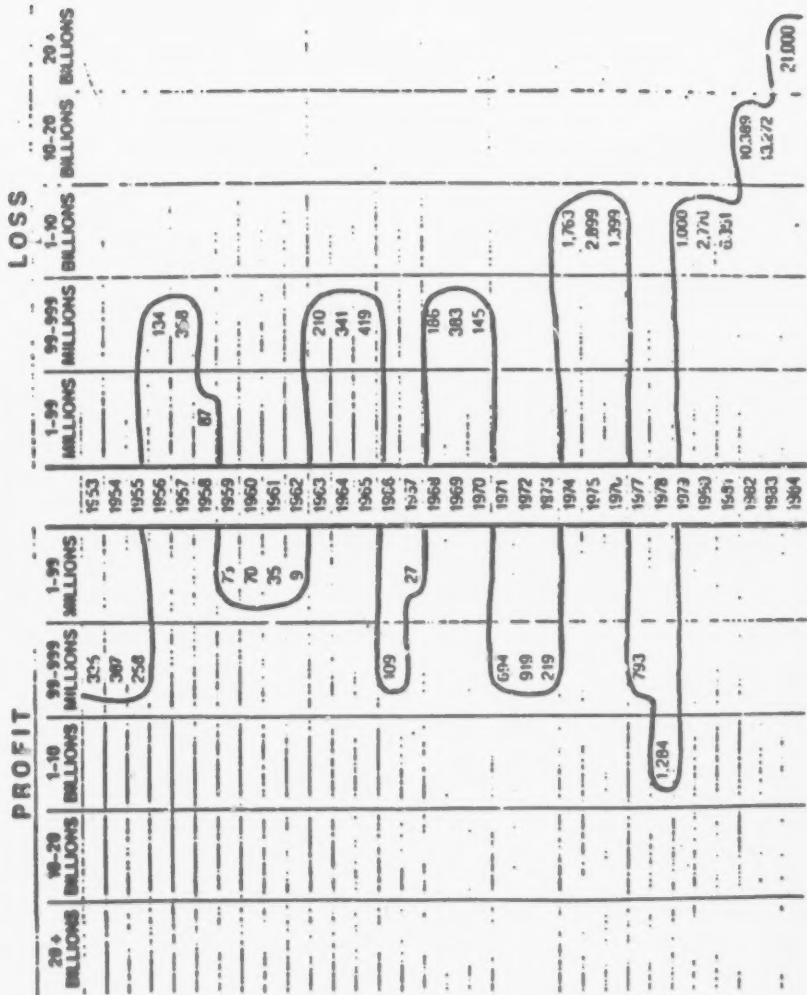


EXHIBIT B

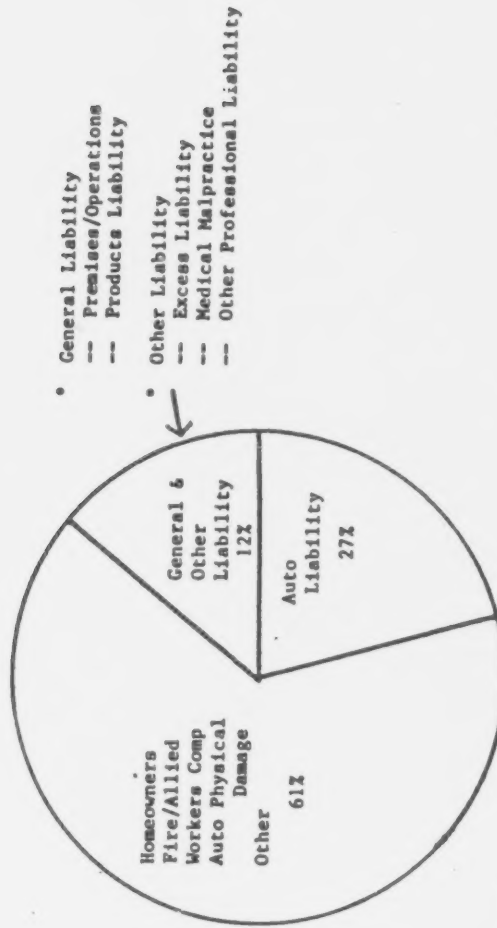
• TOTAL P/C INDUSTRY VOLUME

\$124 BILLION

• TOTAL LIABILITY INSURANCE VOLUME

\$46 BILLION

1984



1984 - Best's Aggregates and Averages

EXHIBIT C

NATIONWIDE COMMERCIAL INSURANCE
EXCLUDING WORKERS COMPENSATION

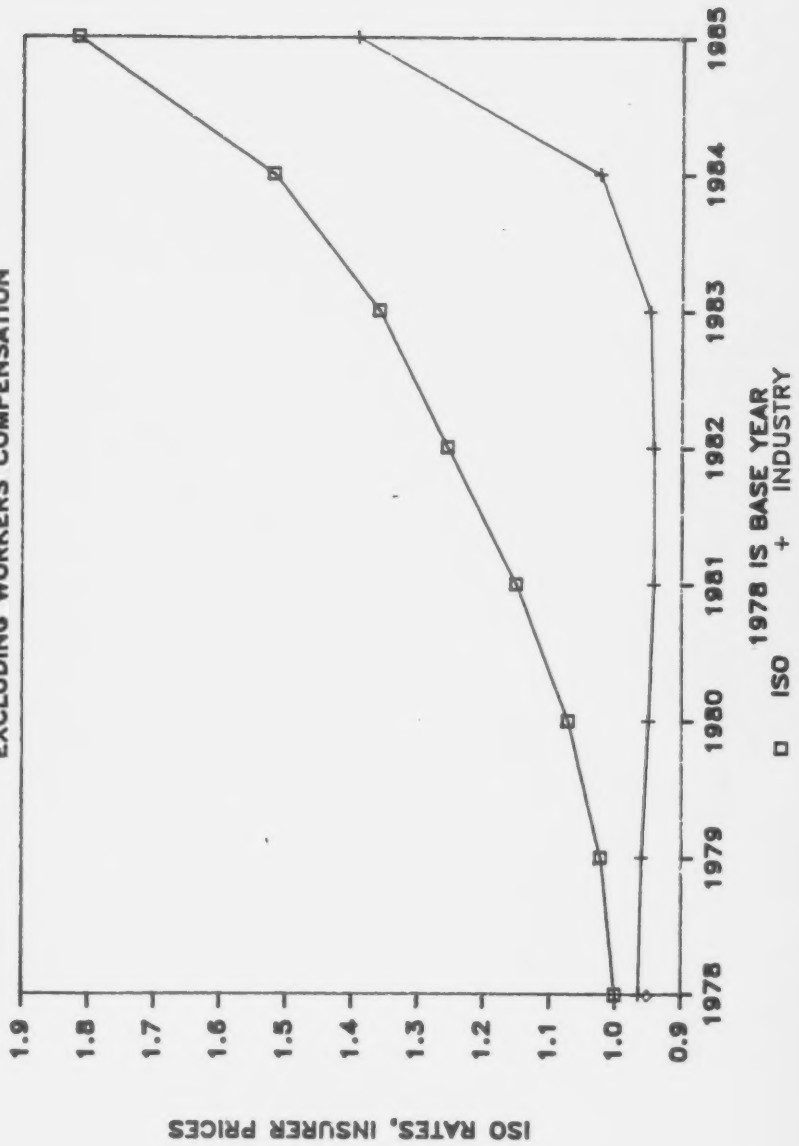


EXHIBIT D

LIABILITY MARKET PROBLEMS

- PRICE INSTABILITY
- AVAILABILITY
- SMALL NUMBER OF "CRITICAL" PREMISES AND PRODUCTS LIABILITY CLASSES
- OTHER SPECIALIZED LIABILITY CLASSES

Critical Classes--4% of premium writings
 • Est. 15% of 1600
 Premises/Products Classes

Other Critical Lines--3% of premiums
 • Medical Malpractice
 • Other Professional
 Liability
 • Excess Insurance

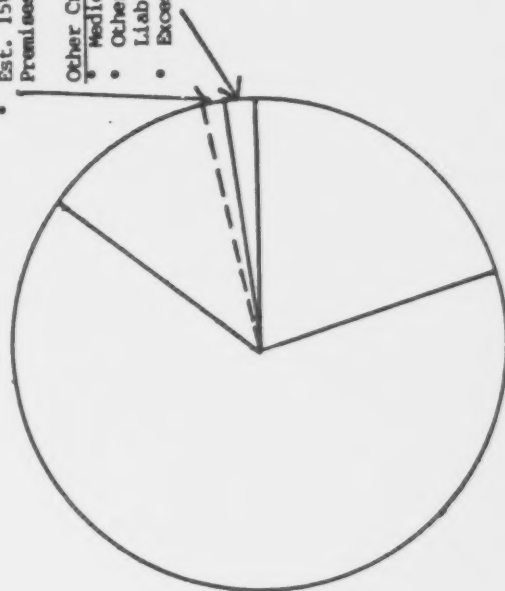
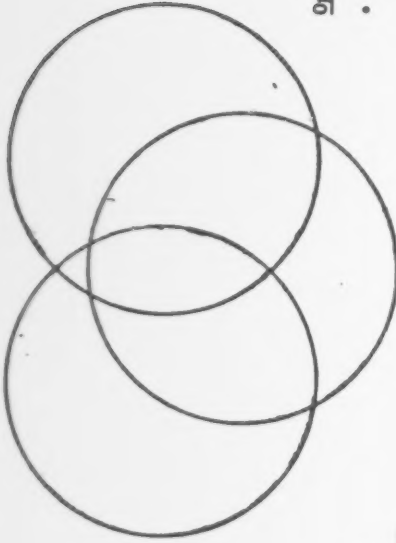


EXHIBIT E

DYNAMIC INSURANCE MARKETPLACE

- THREE INTERRELATED ENVIRONMENTS
- EACH IMPACT RATE OF RETURN

Socio-Legal Environment

- Expanding tort theories
- Social inflation
- Frequency/Severity of loss

Operating Environment

- Competition:
 - market participation
 - price
- Economic outlook
- Internal expertise

Regulatory Environment

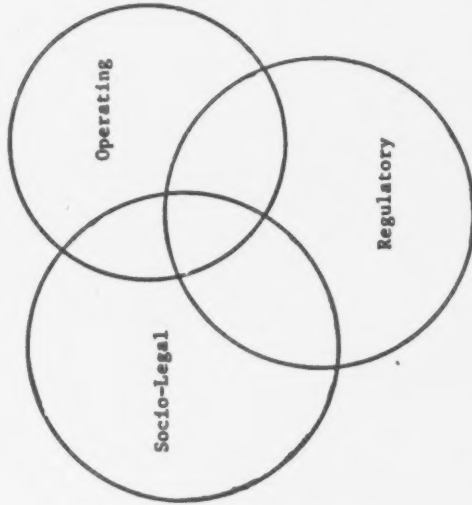
- Freedom of form
- Freedom of rate
- State/Federal regulation

EXHIBIT F

THREE ENVIRONMENTS

- IMPACTS VARY BY LINE OF INSURANCE
- DEGREE OF RISK EVALUATED IN MARKET PARTICIPATION DECISION

PROPERTY INSURANCE



GENERAL LIABILITY

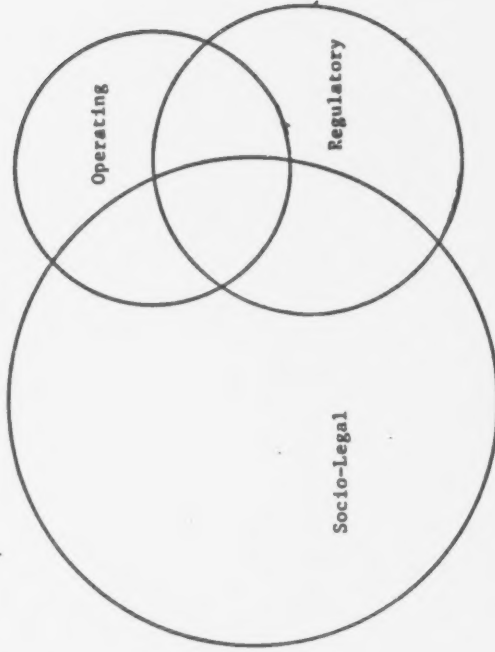


EXHIBIT G

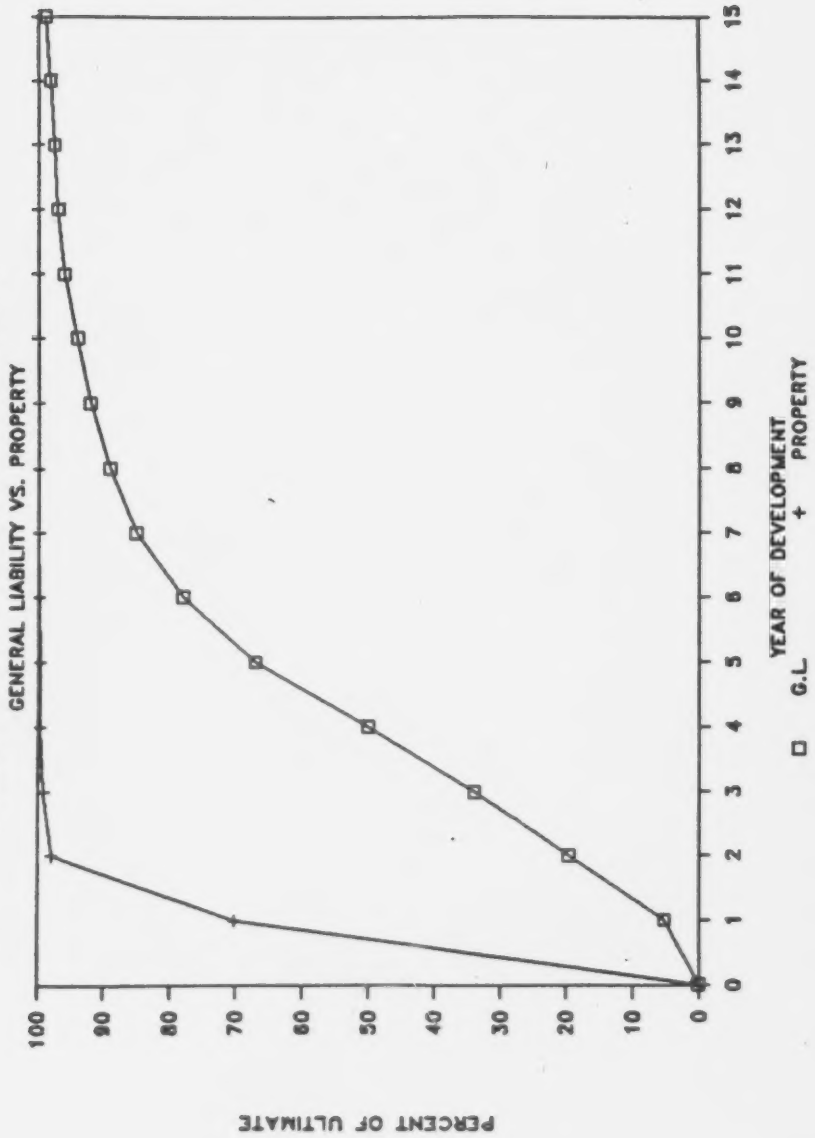
PAID LOSS DEVELOPMENT

EXHIBIT H

RISK/RETURN MATRIX

<u>LINE</u>	<u>PROFIT MARGIN</u>	<u>AMOUNT OF RISK</u>	<u>TAIL COMPONENT</u>	<u>OVERALL ASSESSMENT</u>
	MEDIUM-HIGH	LOW-MEDIUM	SHORT	ATTRACTIVE
PROPERTY	LOW	HIGH	MEDIUM	UNATTRACTIVE
AUTO LIABILITY	HIGH	LOW	SHORT	ATTRACTIVE
AUTO PHYSICAL DAMAGE	LOW	HIGH	LONG	UNATTRACTIVE
WORKERS' COMPENSATION	LOW	VERY HIGH	LONG	VERY UNATTRACTIVE TO UNACCEPTABLE
GENERAL LIABILITY	LOW			

EXHIBIT I

IMPACT OF UNDERESTIMATING LOSS COST INCREASES
ON LOSS RATIO

LINE	LOSS PAYOUT PERIOD (Years)	PROJECTED LOSS COST INCREASE	ACTUAL LOSS COST INCREASE	INCREASE IN LOSS RATIO*
Fire	1	50	100	2 Points
		10	15	2
		5	15	5
		10	20	5
		5	20	7
Auto Liability	5	50	100	13 Points
		10	15	12
		5	15	29
		10	20	27
		5	20	47
General Liability	10	50	100	30 Points
		10	15	28
		5	15	74
		10	20	69
		5	20	140 Points

* Assuming a 50% expected loss ratio

EXHIBIT J

PRESSURES ON INDIVIDUAL
RISK UNDERWRITING DECISIONS

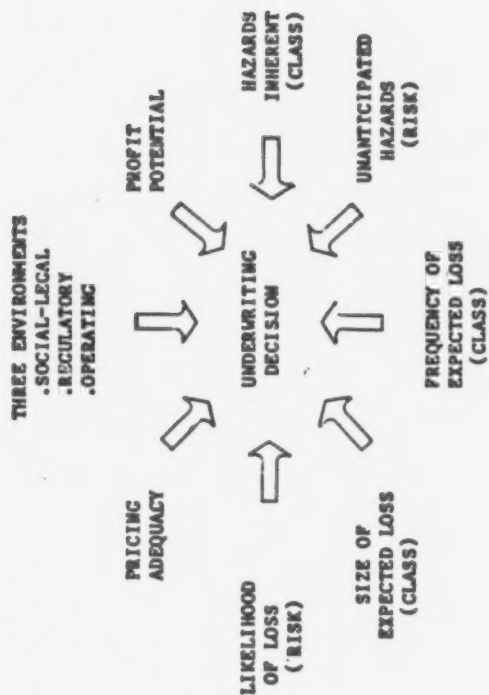


EXHIBIT K-1

CLASS EVALUATION MATRIX

Factor Evaluation	Retail Grocer	Day Care Facility	Municipality
<u>Hazard/Loss Causes</u>			
• Historic	Identifiable/stable	Identifiable/severe but reasonably stable	Most identifiable/complex/unstable
• Prospective	Reasonably stable	Severe/increasingly unstable • Sexual molestation • Parental kidnap	Continued complexity/instability • Joint & several liability • Concurrent causation
<u>Hazard Controls</u>			
• Historic	Readily identifiable/definable	Difficult to poor	Difficult to poor
• Prospective	Readily identifiable/definable	Poor to none	Very Difficult to none
<u>Rise In Total Loss Costs</u>			
• Historic	+ 13% per year	+ 21% per year	+ 18% per year
• Prospective	+ 15 to 20% per year	+ 30 to 40% per year	+ 25 to 50% per year
<u>Underwriting Risk Assessment</u>			
• Historic	Attractive	Unattractive	Very unattractive
• Prospective	Attractive	Unattractive to unacceptable	Very unattractive to unacceptable

EXHIBIT K-2

INDIVIDUAL RISK UNDERWRITING ANALYSIS

Class	Retail Grocer	Day Care Facility	Municipality
Loss Characteristics	High Frequency/ Low Severity	Low Frequency/ High Severity	Mod.-High Frequency/ High Severity
Historic Expected Hazards	- Slips & Falls - Crowds - Falling Objects - Degree of Supervision - Spoilage/Contamination - Improper use of products - Other product BI/PD - Contracts - Liquor Liability - False Arrest/Detainment - Advertising Liability/ - Libel and Slander	- Buildings/Grounds - Swimming pools - Play equipment--in and out - Food - Degree of supervision - Off-site trips - Auto/Bus/other transportation usage	- Hazards Arising From: - School districts - Water districts/facilities - Public utility services - Police/fire services - Sanitation services - Parks/recreation facilities - Public transportation - Land management - Cemeteries - Other Activities/Hazards: - Museums - Wharves/marinas - Arenas - Stadiums - Zoos - Amusement Parks
"New/Evolving" Hazards	- None known - Social inflation considered	- Parental kidnap - Sexual molestation - Other (T)	- New and growing severity of hazard arising from: - Concurrent causation - Expanding tort theories - Social inflation
Hazard Controls	- Ready identification/analysis - Definable controls	- Difficult but definable historic hazards - Poor to none for "new" hazards	- Complex but definable for historic hazards - Poor to none for "new" hazards
Pricing	- Reasonable certainty of predictable future loss - Vary price from "average" only to degree risk differs from "average"	- Loss highly unpredictable -- size, type, timing - No reasonable certainty of future cost - Result: unavailability; erratic pricing, if any	- Loss highly unpredictable -- size, type, timing - No reasonable certainty of future cost - Result: unavailability; erratic pricing, if any

EXHIBIT L-1

Premises Liability Loss Cost Increases

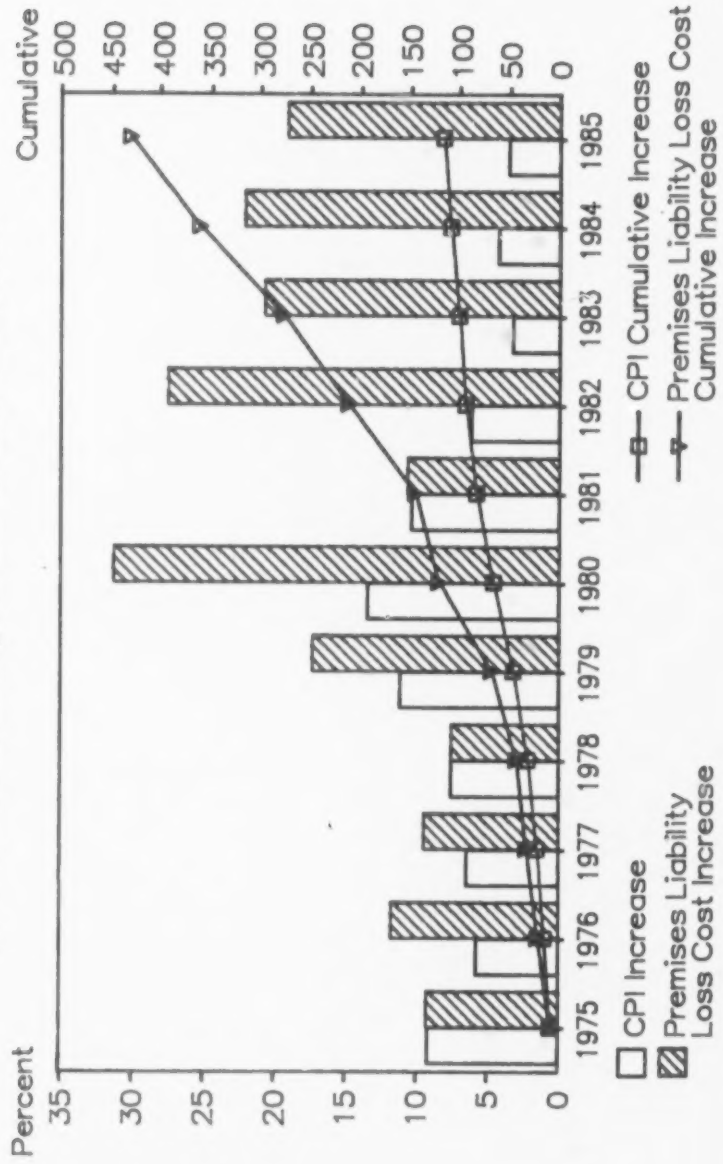
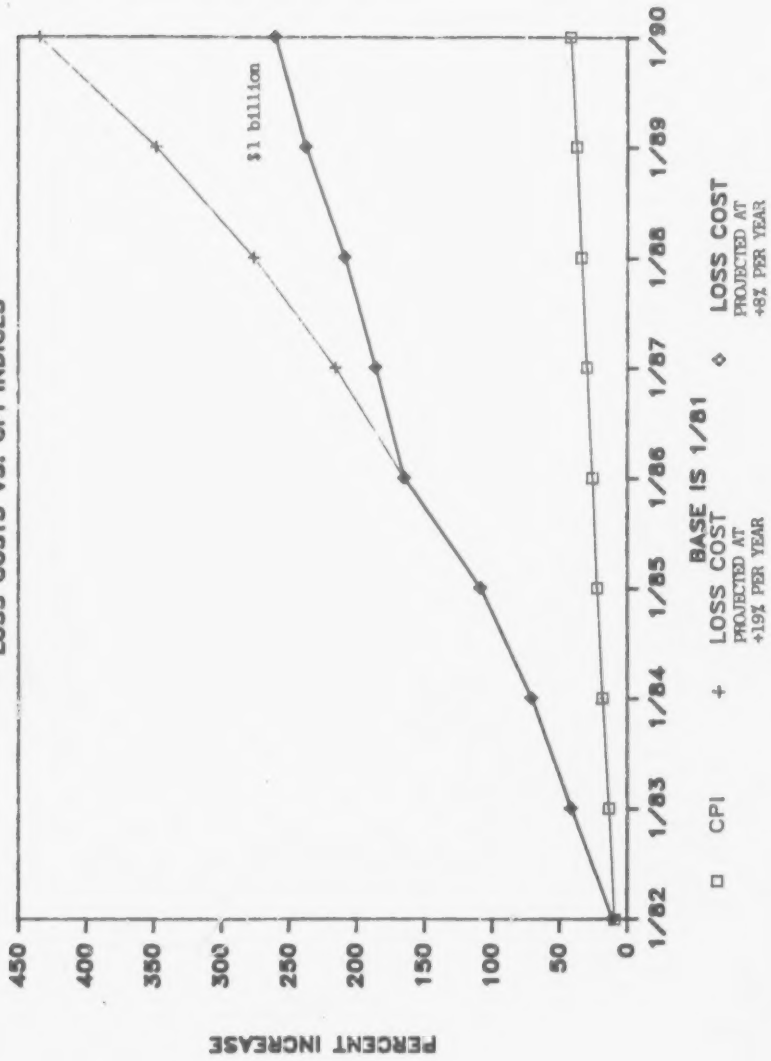


EXHIBIT L-2

PREMISES LIABILITY

LOSS COSTS VS. CPI INDICES



Senator McCONNELL. Thank you, Mr. McCormick.

Now we will go to Mr. Beck.

Mr. BECK. Senator, thank you.

Senator McCONNELL. If you could please try to sum up in about 5 minutes, we would appreciate it.

STATEMENT OF LOWELL R. BECK

Mr. BECK. I will not only not read from my prepared statement, I will hand it in for the record, I will also not use my summary notes. I will just talk for a couple of minutes and try to supplement what Mr. McCormick has said, because much of what he has said I would agree with.

I do represent the National Association of Independent Insurers. This association is an organization of some 500 companies throughout the United States in all lines of insurance.

There were so many things said by the plaintiffs lawyers who were here earlier that could more than take my 5 minutes. I guess one thing that I would suggest to the committee with regard to the cases that they discussed, the defense of cases, it might be very well if at another time you would invite defense lawyers to appear. Perhaps you had them before, but I will not attempt to get into those kinds of things that they discussed today.

One thing I do want to mention, because they did point out to you about the companies and how they delay and how they simply do not want to settle, they do not in effect want to serve clients. There is a very different side to that. Companies in your own State, like the Kentucky Farm Bureau, for example, have an exemplary record of moving right out to make certain that their customers are served. And I could cite and will not take your time but could cite case after case of where companies bend over backwards to get their claims dealt with fairly and quickly.

There probably are situations like these gentlemen mentioned, and we cannot condone those if that is the case, but there is another side.

Now, having said that, what are these real causes that are taking place? I wish that Senator Simon had not left at this point, because I was pleased to hear him say earlier that there is a little bit of blame to go around. We acknowledge that in this industry. Even though we are charged with fomenting a conspiracy and all getting together and deciding we are going to withhold our products from the marketplace, if that indeed is the case, we are covered under the McCarran Act. We are clearly covered under the antitrust laws with regard to boycotting and intimidation and conspiring.

We also do not engage in price fixing, but that is a whole different day for another subject when the McCarran-Ferguson hearings come. We just are not to blame for those things and, if we are we suggest that the Justice Department be called into this to take a careful look at it.

Where I think it can be said, where I think there can be some blame in the last few years is in the area of what we call cash-flow underwriting, which you have all read about and know about, where insurance companies did reduce rates. Those critics of ours

have talked about that. There was a period of time when perhaps we underpriced our products, the industry went too far below what they should have in order to reap some rewards of high investment income. We acknowledge that. That did occur in many instances.

It is interesting, however, that the critics today were not around then to suggest that we were underpricing our products. In fact, at that very time they were talking about how important it was to have strict guidelines with respect to passing investment income savings on to consumers, when in fact that really was taking place. But clearly that was a problem.

At about the same time that this was occurring, when companies were very interested in market share, the caseloads in the tort system did begin to expand, tort law was being liberalized and all of a sudden this industry found itself in a position of not just cash-flow underwriting but it found itself developing a very serious loss condition.

Now, those facts and figures are there. They are open information in all State regulatory agencies today for everyone to see. They are reported to State regulatory officials. This industry was writing at about 118 combined ratio, much more than that for commercial lines, which means that it was paying out \$1.18 or \$1.34 or \$1.40 for every dollar it was taking in.

And then about 2 years ago it came to the point where investment income no longer would carry that, that additional excess that we were paying out beyond premiums, and the industry found itself in a very serious loss position.

Now, what are we doing today? And the other gentlemen will address this and I will just mention in an overview very briefly. The industry is working with State regulators to develop and put into place—and this has already happened in 30 States—market assistance plans to try to identify those areas where insurance simply is not available or almost impossible to get; it is working with regulators to identify them and then attempt to move companies in to handle those situations where the need is very great. That is working now in many lines in some 30 States that have put that into account.

Also, the National Association of Insurance Commissioners has established a nationwide clearinghouse that we, as an industry, are working with and cooperating with, not to just identify areas that are difficult, but again to try to get insurance placed. We could be here for 2 hours talking about the availability situation and whether or not the crisis is as bad as it seems, but it is already starting to be relieved in some areas. Day care, for example, which was No. 1 on the list for some time, we are beginning to see that it is not quite the problem that we thought it was going to be.

Tort reform—and then I will end—we are working throughout the country there; but it is not just the insurance industry, it is groups of insureds who are going to State legislatures and asking for change in tort reform. We see that as the long-range solution. We are happy to report that so far this year six legislatures that already have adjourned have passed effective tort reform dealing with frivolous suits, punitive damages, and joint and several liability, so this is occurring. We see it primarily as a State issue, Senator, as you know, to deal with at the State level because we are

talking essentially about State law, State personal injury law that is involved. Thank you.

[The prepared statement of Mr. Beck follows:]

STATEMENT OF
LOWELL R. BECK
PRESIDENT
NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

On behalf of the National Association of Independent Insurers (NAII), I want to commend you, Senator McConnell, for your interest in addressing serious problems within our civil justice system. I am Lowell Beck, President of NAII, an insurance trade association representing approximately 500 property/casualty insurance companies. NAII members range from the largest multi-state insurers to smaller one-state writers.

I would like to take a moment to give you an overview of the financial condition of the property/casualty insurance industry, for it is inherently intertwined with the issue at hand, civil justice reform. In the late 1970s and early 1980s, the insurance industry experienced a surge of fierce competition, as insurers competed heavily against one another by pricing their products to obtain more premium dollars and take advantage of higher interest rates. At the same time the underlying liabilities assumed by property/casualty companies were expanding at a heavy pace, there was an explosion in the number and amount of damage awards issued by the courts.

For a short period of time, investment income earned by insurers on the assets they held countered and actually compensated for the underwriting losses they incurred. Few believed them when they said our personal injury law needed reform. Gradually, however, the losses outstretched investment income. By 1984, underwriting losses exceeded investment income by 3.8 billion dollars. Throughout the early 1980s the return on net worth for property/casualty insurers moved increasingly below the average rate for Fortune 500 companies. In 1984, our return on net worth plunged below two percent, while the rate for the Fortune 500 was 13.6 percent.

The underpricing of policies, declining investment income and expanded liabilities moved the industry into dire financial straits and culminated in the disaster known as 1984. That year we sustained an underwriting loss of 21.5 billion dollars and an operating loss of 4 billion dollars. The results

from 1985 showed no significant improvement in the financial condition of our industry. Last year we set a new record for underwriting losses, which reached 25 billion dollars. These major losses in turn led to a sharp decrease in property/casualty insurers' surplus and an increase in the number of insurance insolvencies. In 1984 alone, over 80 insurers lost more than one-quarter of their surplus. In 1985, well over 200 insurance companies were targeted by the National Association of Insurance Commissioners as in danger of insolvency. That was the highest number of companies targeted in a single year, and represented a 73 percent increase over the previous year.

Though the industry suffered substantial operating losses in the 1980s, the deficits were offset by other sources of income, including capital gains, which result when insurers sell assets that have risen in value since purchase. Until recently, the capital gains realized by property/casualty insurers were relatively insignificant compared to their overall net worth. Between 1975 and 1982, capital gains never exceeded more than one percent of company net worth. In 1983, however, insurers' capital gains reached three percent of net worth. In 1984, it grew to four percent. The point is our companies' recent dismal financial results would have been even worse without these unprecedented capital gains and tax credits. Capital gains and tax credits, however, cannot be relied on to bail us out in the future as they are only temporary saviors.

During these tumultuous years, property/casualty insurers grew increasingly dependent upon reinsurers, or companies that insure insurers. Reinsurance provides a crucial link in our insurance system because in many cases the potential claims are too large and uncertain for any single company to absorb. Reinsurance companies, however, have fared even worse in the last two years than the rest of the industry. Though from 1979 to 1983 reinsurers' performance generally tracked that of the industry in general, in 1984 reinsurers' net worth plummeted to a negative ten percent, while other insurers had a positive return of less than two percent.

Faced with these huge losses, depleting surplus, and constricting reinsurance, insurers were forced to focus their limited capacity on less dangerous risks, creating insurance availability problems for commercial risks in particular.

During the last several months, critics have charged that we manufactured the insurance shortage, engaging in a group boycott in violation of federal antitrust law. If they have proof of a conspiracy, they should present it at once. If they do not present the evidence, they are withholding evidence of a crime. If they don't because the evidence does not exist, they have been misleading the public. Most leading executives in this industry acknowledge that pricing during the past few years has contributed to the insurance problems of today. But what were the critics saying at that time? Generally, they were accusing the industry of overpricing and demanding rigid guidelines for the inclusion of investment income in rate-making.

In the face of adverse economic conditions in the past two years, the insurance industry has taken positive steps to relieve marketplace difficulties. These include participation in the market assistance programs that have been set up in about 30 states, the NAIC Clearinghouse which is similarly designed to enhance availability, and formulation of new policy programs. These actions have already helped relieve insurance shortfalls and will continue to do so. We will, nevertheless, continue to face insurance availability dilemmas for the foreseeable future unless and until we get to the root cause of the financial losses I outlined for you: fundamental inequities within our civil justice system. While the insurance shortage was aggravated by the early 1980s' price reductions, the ultimate causal factor lies in losses imposed by the civil justice system. Rapidly changing standards of causation and liability have become so unpredictable and liberalized that the insurance industry often cannot assess liability risks with any confidence. In the courts we have also witnessed an explosion in the number and amount of awards, particularly for punitive damages and noneconomic loss.

I emphasized the poor economic performance of our industry because that performance has a direct bearing on the issue at hand, tort reform. Deficiencies within our personal injury law, however, lie primarily at the state level and must be resolved by state legislators and regulators. We are happy to report that already in 1986 five state legislatures that have adjourned enacted significant tort reforms, and many other states are currently considering similar action. Where problems exist within our federal system, they should be addressed by federal policymakers.

We commend you, Senator, for exploring the important issue of tort liability, and we appreciate the opportunity to express our agreement with you as to the necessity for reform. We will continue to work with you and other federal and state policymakers to resolve these problems and restore our industry to profitability in order to ensure availability of insurance for all consumers in the United States.

Senator McCONNELL. Thank you, Mr. Beck.
Mr. Nutter.

STATEMENT OF FRANKLIN W. NUTTER

Mr. NUTTER. Senator McConnell, I am Frank Nutter, president of the Alliance of American Insurers. I too will honor the commitment to restrict the statement to my oral remarks.

We come here today as well to speak favorably about the need for reforms in the civil justice system. We think that it is necessary to restore the concept of fundamental fairness to all parties that are part of that civil justice system and to establish the legal environment that is necessary for a stable business environment.

We also believe that it is important to reinstate the viability of the commercial insurance marketplace. Perhaps at no time in our country's history has the relationship between insurance and the tort system been better highlighted. Perhaps the importance of insurance to the economy has been no better understood.

Businesses, governments, local governments, professional groups have come before this committee, State legislatures, and many other congressional committees expressing their concern about the availability and the affordability of commercial insurance. Their pleas are often strident. They are strident because these entities are threatened by the civil justice system. Their demands regarding insurance are understandable because of that threat. Insurance provides a security that they need.

The issues surrounding the availability and affordability of insurance are not issues of business versus insurers or insurers versus doctors or, notwithstanding the earlier panel, even lawyers versus insurers. Businesses, those that are insured and those that are self-insured, fully understand what their claim experience has been. They are fully aware that they are deep pocket targets of the system. Many lawyer groups have indeed examined the system and called for reforms.

The dialog before this committee and certainly before many State legislatures often comes down to a specific question: Will meaningful tort reform affect the availability and the affordability of insurance? The answer, Senator, is yes.

That answer presupposes certain things: that we can agree on those reforms that will stand up against the inevitable legal challenge that will be made to them. It presumes that we will adopt broad reforms and not narrow, superficial ones. It assumes that these reforms will be reflected in the claim experience of the insureds and the self-insureds, even as we protect the right of the victim for economic and some reasonable amount of noneconomic damages. It assumes that these reforms will restore confidence to the consumers of the civil justice system, and it assumes that these reforms will not be adopted in the context of severe rate regulation of insurers or the introduction of political judgments into the insurance process.

Often the question that I previously asked is succeeded by a question asking for quantitative, specific rate adjustments if certain reforms are adopted. It is an understandable question. It is un-

derstandable for you as public policymakers to try to respond to constituents who want pocketbook answers to these questions.

It is less understandable and less tolerable as a ploy to maintain the status quo. As an industry, if we could produce specific rate adjustment figures for specific changes in legal doctrines, we would come forward with it. It would be in our interest to do so.

Unequivocally, the elimination of joint and several liability and the adoption of several liability, the introduction of modified comparative negligence, and some reasonable limitations on punitive damages and on noneconomic awards will be reflected in the claim experience of our insureds and those that are self-insured. This cost mitigation will be built into pricing decisions. In our competitive industry, the consumer will benefit.

Costing tort reforms sounds simple. It would be persuasive if we could do it, but it is highly speculative. There are open questions. Will public attitudes change regarding judges and juries and the awards that they grant? What will future economic conditions be? Will the tax policy of the Congress affect the insurance industry and the value of claims? Are there other legal doctrines that we have not addressed that will continue to change?

If all socioeconomic conditions remain equal, if these reforms reduce costs, competition will reduce price. Insurers can no more commit to the value of specific changes in legal doctrines than the self-insured business can commit to specific reductions in the price of the product, nor the self-insured government commit to specific tax decreases if you adopt these reforms.

Insurance is a passthrough mechanism operating in a highly competitive environment. Over time it must reflect its costs. It operates in an external environment of laws, of our societal attitudes, and of the economy. Those things affect the insurance costs. Prices in the insurance industry will respond. Insurers are pricing their contracts today to pay for tomorrow's costs, determined in a legal system that they do not know. If the civil justice system remains unchanged, I can guarantee you that prices in insurance will remain high. If it is changed, the prices will reflect the impact that is being experienced in the costs of the insurance product. Thank you.

[The prepared statement of Mr. Nutter follows:]

Statement of

Franklin W. Nutter
Alliance of American Insurers

Mr. Chairman, members of the Committee, I am Franklin W. Nutter, President of the Alliance of American Insurers, an association of 175 property/casualty insurers. We appear today to speak favorably regarding the need for reforms in our civil justice system if we are to restore to the system the concept of fundamental fairness and that legal stability necessary to reinstate a viable and affordable commercial insurance market.

At no time in our history has the importance of commercial insurance to our economy been better highlighted nor the integration of insurance with our tort system better observed. Before the Congress, state legislatures, and regulatory bodies parade the nation's business, state and local government and professionals expressing their concerns about the affordability and availability of commercial insurance. Two things stand out in their plea for legislative relief: First, they are well aware that their insurance problems are rooted in today's legal environment, and secondly, that insurers' problems are closely integrated in the difficulty these entities have in assessing their own risk exposure. After all, why is the availability of insurance so important today: Because it is the uncertain threat of liability emanating from our civil liability system which sparks the demand for the security offered by the insurance product.

These businesses, governments and professionals know that the insurance problems are but a symptom of imbalances in what one newspaper described as America's heart of darkness--the civil justice system. The issues surrounding it are not a confrontation between insurers and businesses, nor insurers versus doctors, nor even insurers versus lawyers as the media too frequently depicts. Businesses and doctors know of the deteriorating claims experience in their fields; self-insured businesses and governments are well aware that they are deep pocket targets, and objective lawyers recognize the tort system is being exploited.

Me of the insurance industry are at work in coalitions of businesses, lawyers, governments and professionals in 34 states in 1986. Of 45 states with legislative sessions this year, 37 have active tort reform agendas. Undoubtedly, 1986 and 1987 will mark years of consensus building and action among affected groups seeking to restore the system to fairness for victims of products and services and to the providers of these products and services. The consumers of the system, business and insurers, are working closely to find solutions to today's liability problems.

In the dialogue which has transpired on these issues, no question recurs so frequently as the following: If we support meaningful tort reform, will it make a difference in the availability and affordability of insurance? The answer is yes.

The question and the answer presuppose that we can agree on which reforms will stand up against the inevitable legal challenge by some segments of the legal community. The question and answer presume that broad reforms applicable to business and professionals will be enacted and not superficial reforms directed narrowly at one segment of the problem. The answer anticipates that the reforms will enable those entities which are insured and self-insured to experience reduced claim severity, frequency, and transaction costs while preserving the victim's right to recover economic loss and reasonable non-economic awards. The answer presumes that the reforms will stabilize the legal environment, and in doing so, restore confidence in the system among business, professionals, insurers, and for that matter, the public at large that they will be treated fairly. Lastly, the answer presumes that reforms will not include restrictive regulation of insurers which make them uncompetitive or introduce regulatory and thus political judgment in the marketplace.

All too frequently, legislators perceive the need for quantitatively specific commitments of rate adjustments if certain reforms are enacted. The demand is understandable given constituent's desire for pocketbook answers to complex matters; it is less tolerable as a ploy by those who

seek the status quo, and it is frustratingly difficult to address for the insurance industry. Unequivocally, proposals for the elimination of joint and several liability, modified comparative negligence, and restrictions on non-economic and punitive damages will be reflected in claims experience of the companies. Since insurance is a cost-based product, the cost mitigation achieved will be built into pricing policies. In an industry of 2,000 companies as competitive as today's marketplace, the consumer will undoubtedly benefit.

Costing specific tort reforms sounds simple, would be persuasive for the proponents of reform, and yet is a highly speculative exercise. Empirical studies of medical malpractice reform enacted in California in the mid-1970s show that several reforms now being considered have had a dramatic impact on the value of claims and thus the insurance marketplace. However, insurers are guarded about extrapolating this experience to other businesses and other states. Will the reforms and the current public debate affect public attitudes about awards which will be positively reflected in judge and jury verdicts? Will future economic conditions operate to enhance or restrict awards? Will tax policy affect insurers' overhead? Will the system erode other established legal doctrines or courts over state insurance contract coverage? Will reforms withstand legal challenge?

Insurers price their coverage today and yet their costs are not determined until claims are paid in tomorrow's legal environment. Past loss data becomes irrelevant in a rapidly changing legal environment. Insurers can no more commit to the specific "value" of proposed reforms than the self-insured business can commit to a product price reduction or a self-insured government to a tax decrease. All other socio-economic conditions being equal, if reforms reduce costs, competition will undoubtedly reduce price.

In the mid-1970s a crisis in medical malpractice insurance existed. A three-part "solution" was devised: Create a joint underwriting association comprised of licensed insurers to solve the short-term

availability problem, allow doctors to create their own insurer to preserve competition for the coverage, and enact tort reform to solve the long-term problem. There is a lesson in this experiment. Today, we again have a crisis in medical malpractice insurance, and the doctors know it was not created by the traditional insurance industry. Tort reforms were generally modest and attorneys either challenged them in court or found ways around them. Too often regulators suppressed insurance rates even as claim frequency and severity rose dramatically. Doctor-owned mutual insurers began experiencing severe financial problems from the combination.

Insurance is a pass-through mechanism operating in a highly competitive marketplace: Over time, it must reflect costs. As the external environment, legal, social or economic affects costs, insurance prices will respond. Today's pricing reflects tomorrow's costs as best insurers can judge them. If the civil justice system remains unchanged, prices will remain high; if liability standards are changed, prices will reflect their impact.

Senator McCONNELL. Thank you.
Mr. Chittenden.

STATEMENT OF THOMAS S. CHITTENDEN

Mr. CHITTENDEN. I know you are from somewhere in the South, because in the North it is Chittenden and in the South it is Crittenden. That is a long historical explanation which I will not go into. It is——

Senator McCONNELL. It is Crittenden in Kentucky.

Mr. CHITTENDEN. It is Crittenden, indeed, in Kentucky.

I will not repeat what the previous witnesses have said. I agree with all of it. I want to just offer a couple of comments though.

In the debate that is going on, the insurance industry is often referred to as though it were a monolithic something that everybody can grab a hold of. In fact, the insurance industry, so-called, is a very heterogeneous collection of very competitive entities. Moreover, it is organized into different segments, reinsurers, direct writers, as well as surplus line companies that are not regulated in the same way at the State level. Indeed, if you trace it back far enough and broadly enough, we are dealing with a worldwide mechanism of both great delicacy and wonderful resiliency which is designed to assume risk and to spread it literally around the world.

So it really is not in my view something that contributes too much understanding to the dialog to refer to "the insurance industry," and I would commend this committee and its staff to a real attempt to understand the nature of the industry.

We have a concomitant responsibility to provide you with explanations, insights in this regard as well as the facts in terms of loss development and that sort of thing.

I have submitted a written statement on behalf of the American Insurance Association, of which I am general counsel. That statement, partly by prearrangement with the other trades, goes into somewhat more detail than other statements by way of suggestions and questions regarding the specifics of S. 2046. I will not take your time to go through all of those comments and suggestions. We have a long witness list today. We are very willing and able to dialog with staff or whomever on the specifics.

I would say two things, however: One, in terms of AIA's priorities—and I think broadly the industry does not disagree with this, as you heard from others—that several liability—and I would argue across the board and not just for noneconomic damages as you have drafted—is a very important reform, and if we had 45 minutes we could go into detail on the reasons for that.

Second, caps on noneconomic damages—whether \$100,000 is the right figure or not is debatable—but reasonable caps are very important. Third, a broad repeal of the collateral source rule so that duplicate compensation and inefficiency are removed from the system is also a fundamentally important reform. And finally, reform of punitive damages, both a stricter standard for determining the imposition of punitive damages and also some reasonable cap is also a very important reform.

That is the core of the program which we are all working hard together on with many business and governmental interests at the

State level. I think it is fair to say that at least the AIA prefers at least for the time being to see how we go at the State level given the traditional concerns of States with the tort law system.

However, AIA has a history of flexibility in this respect. We were one of the earliest and most vigorous supporters of Federal product liability legislation. Looking back a little further in time, we were the leaders, I think it is fair to say, in the attempt in the seventies to achieve Federal no-fault standards. So we are more than willing in an openminded way to work with this committee in any way that is appropriate without standing on any absolute principle.

Finally, one other comment I have made in my written presentation I think bears repeating orally. You have limited your proposal, your substantive reforms, to civil actions of a certain type in the Federal courts. I do not know all the reasons why you did that, whether it is some constitutional doubt or practicality or whatever, but the allocation of overall caseloads between the Federal courts, when we are talking negligence actions, versus the State courts, is very heavily on the side of the State courts.

Senator McCONNELL. Ninety-five percent.

Mr. CHITTENDEN. I was going to say 90 to 95 percent. And as I read your bill, these standards would not apply to that 95 percent of the cases, at least unless there were some rush to the Federal district courts by way of removal on diversity grounds or what have you.

Senator McCONNELL. Since you posed the question, let me play witness for a minute.

Mr. CHITTENDEN. All right.

Senator McCONNELL. The reason for crafting the bill the way we did it was a feeling that a variety of folks, and I gather all four of you are in that category, would prefer to see action at the State level, and the assumption was that since 95 percent of the cases in America were in the State courts, that the action ought to occur down there.

We were interested, however, in the 5 percent, and even though State law would be applied in those cases, presumably it got into Federal court under diversity jurisdiction, what we were seeking to do here was to preempt the law of damages only in cases that got into Federal court. I think you could make a persuasive argument, although I do not think any of you are for this, for preempting the damage field throughout the country in the interest of uniformity. But I gather that almost everybody in your industry would rather drink poison than see any Federal legislation maybe outside of—

Mr. CHITTENDEN. No, I am not arguing for total preemption at this point, as I just said. I am merely pointing out—and perhaps I am being inconsistent, if I am honest about it, that 5 percent of the problem is 5 percent of the problem. But beyond that, it may set up some tensions as between the State and Federal systems that may add to litigation inefficiencies, and I think we are all going to have to look very carefully at that. Thank you.

[The prepared statement of Mr. Chittenden follows:]

Statement of
Thomas S. Chittenden
Senior Vice President and General Counsel
of the American Insurance Association

My name is Thomas S. Chittenden and I am Senior Vice President and General Counsel of the American Insurance Association, an organization of 177 insurance companies writing property and casualty insurance of all kinds throughout the United States. Member companies of the AIA represent approximately 35% of all commercial premiums written in this country.

S. 2046, styled as the Litigation Abuse Reform Act of 1986, would establish Federal rules of law governing periodic payments (Section 2122); collateral source benefits (Section 2123); damages for noneconomic losses (Section 2124); contingency fee agreements (Section 2125); punitive damages (Section 2126); and counsel's liability for excessive costs (Section 2127). These rules would apply to certain civil actions in the Federal courts.

Senator McConnell is to be commended for introducing S. 2046. It is the first bill introduced in the Congress since the beginning of the "insurance availability crisis", so called last year, that would impact on the substantive rules for conducting liability actions across all personal injury litigation in the Federal courts. I need not rehearse before this Committee the vast and escalating expansion of the tort liability system over the past 10 years that has left many commercial insurance buyers struggling to afford steep premium increases* and has left insurance underwriters with little if any confidence that they can find any reasonable basis at all for predicting future losses. Suffice

* Critics of the insurance industry have argued that the industry underpriced its products during the 1979-1984 period and should not, therefore, be allowed to "get away" with sharp price increases now. The fact of the matter is that even though competition in the early 1980's unduly depressed premium levels (as it turned out), liability losses have been steadily and significantly increasing during the entire period, such that insurers need substantial price increases just to keep up with predicted loss development for current periods forward. All of this is documented in Insurance Services Office publications and other industry materials that I believe have been previously forwarded to this Committee.

it to say that the tort liability system has expanded to the point that for many claimants it provides very handsome compensation indeed without regard to proof of the individual responsibility -- let alone the culpability -- of any defendant or group of defendants.

There is a great need for the enactment of measures such as those contained in S. 2046, if a fairer balance is to be struck between the rights and needs of injured persons and the ability of commercial and professional communities to sustain the cost without suffering a decrease in the quality or the reach of the beneficial products and services they provide. AIA is especially pleased to see language in S. 2046 broadly repealing the Collateral Source Rule, establishing several liability for noneconomic damages (Section 2124(b)), limiting punitive damage awards and imposing a cap on noneconomic damages. Underwriters in member companies have indicated repeatedly that in their judgment the four reforms noted above will have a markedly beneficial impact on their ability to predict liability exposures and thus on the availability and price of insurance.

AIA is much less certain that the limitations on contingent fees proposed in Section 2125 of S. 2046 would have any real impact on loss costs. A small number of states (e.g., New Jersey) has had for some time limitations on contingent fee agreements, but there is no solid evidence of a tie-in between such arrangements and a dampening of the frequency and severity of losses.

AIA is presently in the midst of a study of incentives that increase or decrease the likelihood that non-meritorious actions will be brought or pursued, and we thus have no position at this time on the proposal in Section 2127 that an attorney who initiates an action in bad faith be subject to "treble costs, fees and expenses, including attorney fees reasonably incurred to respond to or otherwise resist the action". Speaking personally, I would observe that the mandatory imposition of treble costs (including the opponents' attorney's fees) seems to be a draconian penalty that may well not be merited in all cases in which bad faith might conceivably be found.

It will come as no surprise to this Committee that AIA is working hard with business and professional groups and other insurance interests

to enact tort reforms at the state level, including the four mentioned above. Because federal pre-emption -- especially a partial pre-emption as proposed by S. 2046 -- poses great difficulties of integration with state laws and procedures, and because substantive tort law has traditionally been developed by state courts and legislatures, AIA prefers that solutions come at that level. However, AIA has supported related federal initiatives in the past (AIA was a leading proponent of automobile no-fault standards in the 1970s and has been a vigorous supporter of bills introduced by Senator Kasten that would federally codify major aspects of product liability law). AIA would accordingly be very pleased to work with this Committee and others to develop from the excellent beginning made by Senator McConnell in S. 2046 workable substantive standards for Federal enactment.

In introducing S. 2046, Senator McConnell indicated that the bill "may not have all the answers" and offered "to work with others interested in the problem to arrive at a consensus". Congressional Record - Senate, page 1009 (February 5, 1986). Encouraged by the Senator's openness to dialogue, I would like to make a number of suggestions and raise some questions for consideration by the Committee. These are not exhaustive, nor do they reflect in-depth research, but they may serve to provoke useful discussion:

1. Pre-emption. As written, S. 2046 applies only to personal injury actions in the Federal courts and leaves state proceedings alone. At present, all of the subjects treated by S. 2046, except for Section 2127, are governed by state rules, whether judicial, regulatory or statutory, and the Federal courts apply state rules under the doctrine of Erie R.R. v. Tompkins. If S. 2046 is enacted by the Congress in its present form, this country will have different liability rules in the Federal courts than in the state courts to the extent states do not enact parallel provisions. Forum shopping will become endemic, and there may even be equal protection challenges on the ground that defendants similarly situated to the challenger are able to remove to Federal court through the accident of being sued by a citizen of another state. Moreover, the Federal courts have only a small share of all the personal

injury litigation in this country. Therefore, S. 2046 as written would not affect state litigation, which forms the vast bulk of activity in this area. Common sense would argue that Federal standards should pre-empt state rules regardless of forum.

2. Periodic Payments. It may be better to place the question of periodic payments of future damages in the sound discretion of the trial judge, as it is difficult to say before hand that periodic payment of awards over \$100,000 is always the best course. The bill does not permit payments to dependent heirs of a deceased judgment creditor "unless directed to do so by the court". This suggests that the trial judge may order such payments (or other payments) at a future time. If so, this is an uncertainty that will preclude the purchase of an annuity, since an annuity is premised on absolute certainty before the fact or changes that can be mathematically calculated in advance. The restriction of security arrangements to a trust or an annuity precludes several other ways to secure periodic payments.

3. Several Liability. The provision relating to several liability (Section 2124(b)) only applies to noneconomic losses. Since the unfairness of joint liability applies equally to economic or pecuniary losses, we recommend that the provision be expanded to include all categories of losses. Also, consideration should be given to expanding the subsection to deal with the "orphan share" situation; that is, the clear inability of one defendant in a multi-defendant lawsuit to satisfy its share of a verdict. Should the other defendants be required to pick up the share, or should the plaintiff be obligated to go uncompensated for a share equal to that of the able defendants? Perhaps, since the subject is closely related to joint and several, the drafters should also consider a Federal policy on the fault of the plaintiff. AIA favors a modified form of comparative fault under which the plaintiff is totally barred from recovery if he or she is 50% or more at fault and reduces the plaintiff's compensation by the percentage the plaintiff is found to be at fault up to 50%.

4. Punitive Damages. We would argue that the evidentiary standard for punitive damages should be "beyond a reasonable doubt", rather than

"preponderance of the evidence" as contained in S. 2046. A criminal standard is consistent with the deterrent and punitive thrust of punitive damages. Arguably, the suggested standard for determining liability ("manifesting a conscious disregard" for the plaintiff's safety) countenances reckless behavior or perhaps gross negligence, whereas AIA would strongly urge a quasi-criminal standard that makes it clear the punitive damages will only lie when the defendant knowingly acted in flagrant disregard for the injured party's legal rights. The bill would also seem to give Federal judges some incentive to lean in favor of punitive damages in order to fund the research arms of the Federal court system. There are also several additional provisions that the drafters might consider, including:

- a limitation on repeated awards of punitive damages against a defendant arising out of a single act or course of conduct.
- a cap on punitive damages, either a set amount or a multiple of compensatory damages.
- a provision that the trial judge shall determine the amount of punitive damages once liability has been established.

Once again, Senator McConnell is to be commended for providing a concrete set of proposals for consideration and for soliciting comments and even constructive criticism. AIA is willing to work closely with Senator McConnell and this Committee to develop the proposals in S. 2046 into refined and workable Federal rules that can achieve a better balanced tort liability system in this country.

Senator McCONNELL. Thank you, Mr. Chittenden.

Leaving aside for a moment the question of where any corrective action ought to be taken, whether it ought to be taken in the various States of this country or at the Federal level or some combination of both, the central question—I will never forget Howard Baker in the Watergate hearings said the question was what did the President know and when did he know it. The central question here is to what extent is the current liability insurance crisis attributable to the tort system, and I would like for each of you—some of you touched on this already, but I would like for each of you to give me a brief response to that, leaving aside whether there are cases in the Federal court or State court.

The central question is to what extent is the current liability insurance crisis attributable to the tort system?

Mr. CHITTENDEN. I think in an underlying and long-term sense it is almost entirely attributable to the expansion of the tort law system in some of the ways that you heard about this morning. I would subscribe to Mr. Nutter's assertion that overtime insurance costs are driven by expenses and by losses.

However, in the shorter run, insurance costs are also driven by market conditions—and you have heard a lot of talk and testimony about the cycle and the exacerbation of that cycle by high interest rates and cash-flow underwriting. So I would say in the long run it is systemic and it has to be viewed that way. In the short run, the fact that the "insurance availability crisis" came when it did and to the extent it did has something as well to do with the mechanisms of the insurance industry, the cycles and all of that.

Senator McCONNELL. Mr. McCormick?

Mr. McCORMICK. Yes, I would agree with that. In my written material that I have submitted to this hearing, we have an exhibit C which shows the rate of increase the Insurance Services Office estimates the costs of insurance prices to be. I do not know if you can see this from here, but this chart illustrates what has been happening on the cost side. Due to the price war, the industry did not charge this amount in the marketplace. Starting in 1978 the costs have been going up enormously, exponentially, and we did not make price increases until 1984. By 1985, we were half-way to what our rating agency would tell us we need.

So what happened is because of this court revolution that started in the sixties, we have been building momentum, building stored energy for this explosive exponential growth in legal costs and the price war masked that. It has been building. We just came off longest down cycle in 50 years. Instead of a 3-year up and 3-year down trend, we have had 6 years of price war, so that the insurance prices never got charged to the insureds until we all almost went bankrupt.

Most of you know the Fireman's Fund's story, but we lost \$44 million last year and we had to lay off 12 percent of our work force. We had to add \$600 million to reserves. In other words, the chickens and pigeons came home to roost, and we had been masking that. This rapid catchup in the short term is why the country is screaming.

But this exponentially rising curve is there and it is going to get worse and worse and worse. If we change the laws tomorrow we

would have to make a dramatic revolution just to slow the growth, let alone make next year's insurance costs less than this year. This is an exploding transaction.

There is one other comment I would like to make. I do not want to make you all insurance experts, but liability is what we call a long-tail line. Even after 10 years, only 94 percent of the cases are settled, compared to property, where after 3 or 4 years they are all gone. That means that what I call the sociolegal piece of the equation bears a far higher level of importance than when you have a short-tail line and the courts do not change that much.

We have to guess what are the courts going to be 8 years from now when we write liability insurance and the trend line we see is such that we do not write it very much any more. We do not dare take that business risk, and that is the problem.

Senator McCONNELL. Mr. Nutter?

Mr. NUTTER. Senator, I—

Senator McCONNELL. I think you answered the question, but answer it again.

Mr. NUTTER. Well, I will not be redundant of things they have said. Let me add one thing. When I went to law school in the early 1970's, tort law was taught as a relatively static field. That was happening then and certainly what has happened radically over the years is that new theories of liability and new theories of compensation have been introduced which have made it extremely difficult for insurance companies to know how to price a product in that sort of a dynamic tort law environment. That is part of the problem. The insurance pricing problem is knowing whether or not you are looking at a stable legal environment in the tort area or whether or not it is continuing its relatively revolutionary change.

Senator McCONNELL. Mr. Beck, to what extent is the current liability insurance crisis attributable to the tort system?

Mr. BECK. Very significant, and I just agree with what they have all said and I would suggest that we take a careful look at what the insureds themselves are saying, and they will tell you the extent to which they are being sued, even if they are not at fault, and I think that is one of the large points to make also.

Senator McCONNELL. If the problem then, as Mr. Chittenden said, is systemic or, to put it another way, if you think the whole country is the patient, that it is sick and needs some treatment, whether it is my approach or some kind of approach that is even more comprehensive and preempts the field, what happens if we treat only part of the patient? What happens if only 10 States or 12 States or 15 States do something along the lines that all of us would like to see done but various one of us want to see it done on a piecemeal basis, one State at a time, and others may end up suggesting that we do something on a national basis, even more comprehensive than mine. What happens, gentlemen, if only a few of the States act?

Mr. McCORMICK. Well, for product liability, what will happen is any class that feels it is injured by a product that is sold in 50 States, they will do what we call forum shop. They will go to the State that has the most liberal laws and that is where they will bring suit. So where interstate commerce is affected, you have to have a consistent national law. Let us take premises liability,

where that is State driven, then it is all driven by where the accident occurs. If it occurs in New Jersey, it gets tried in New Jersey, and to that extent it is self-regulating and the prices of insurance will be different in those States that have one set of laws and rules versus another that may be more liberal, where the price of insurance would end up being higher.

Mr. CHITTENDEN. I would just add that the problem will get fixed to the extent that action on the damages side, can fix the problem with respect to instate lines.

Senator McCONNELL. Let me ask you then, bearing in mind your aversion to any kind of State legislation that preempts State law, what if you crafted a bill that preempted only the law of damages, not substantive tort law in a case?

Mr. CHITTENDEN. In the sense of standards of liability and——

Senator McCONNELL. Yes, to sort of set some parameters on a national basis, not just of product liability.

Mr. McCORMICK. I think something like that, particularly the area of product liability.

Senator McCONNELL. I am saying what if you took it beyond product liability? You just dealt only with the law of damages, you did not get into the substantive tort law of State acts, but you just set up some kind of national parameters that would be applied to Federal courts in cases that arrived there or in State courts, they would have flexibility within certain boundaries. I think you could constitutionally do this.

Mr. McCORMICK. That is the question to me.

Senator McCONNELL. I think you could. I can argue about that, but I think you could.

Mr. McCORMICK. I think you could.

Mr. CHITTENDEN. I would have to say, I am not sure what you mean by standards. This I guess would mean parameters within which the States——

Senator McCONNELL. For example, for the sake of discussion, in those States that could set up a system and allow pain and suffering beyond a certain amount, so that you sort of drew an outline around, which the Federal Government frequently does, defining the parameters.

Mr. CHITTENDEN. It would have a broader impact, depending on how tightly you drew the parameters, than specific acts within those parameters in 10 States. I do not think there is any question about that.

Mr. NUTTER. Senator, from our point of view, we also supported the Federal product liability tort reform efforts and we also probably fall in the category as you described us as generally not in favor of Federal preemption of State law, even in the limited area of damages. But I think that your legislation and your questions suggest that as we who are involved in this State-by-State effort to examine the tort system and to make changes in the law really ought to sit back soon and evaluate whether or not we are successful in getting fairness built into those State laws and look again at the question of whether or not Federal preemption makes some sense.

Mr. BECK. The NAI probably is the one that resisted the most here. We still believe strongly in local conditions applying. We feel

that when you go into the localities, into the different States, you do see different conditions and different standards in many areas. There is a lot beginning to happen now. I think it is important for us to bring that message to you here today, that it is bleak but much is happening in the way of changes beginning at the State level.

Senator McCONNELL. OK. Thank you very much, gentlemen, I really appreciate your coming.

I have a slew of questions here that I would like to submit to you all to be answered in writing for the record.

Thank you very much.

We are getting reasonably near the end. We have two witnesses as a panel, Dr. William S. Hotchkiss, who is a trustee of the American Medical Association; and Ms. B.J. Anderson, who is associate general counsel of the American Medical Association, and someone else whom I am not aware of.

STATEMENT OF DR. WILLIAM S. HOTCHKISS, CHAIRMAN, BOARD OF TRUSTEES, AMERICAN MEDICAL ASSOCIATION, ACCOMPANIED BY B.J. ANDERSON, ASSOCIATE GENERAL COUNSEL, AND HARRY N. PETERSON, DIRECTOR, DIVISION OF LEGISLATIVE ACTIVITIES

Dr. HOTCHKISS. Thank you, Mr. Chairman. My name is William S. Hotchkiss, M.D. I am a thoracic surgeon in practice in Norfolk, VA, and I am chairman of the board of trustees of the American Medical Association. With me today are Betty Jane Anderson, AMA associate general counsel, and Mr. Harry Peterson, director of AMA's Division of Legislative Activities.

Mr. Chairman, since our statement is already a part of the record and in view of your excellent summary of the problem in your opening statement, I can be brief.

The problems which for a long time have plagued physicians and therefore their patients indirectly, high premiums and limited availability of insurance, are now plaguing business, municipalities and virtually every sector of the economy. I have viewed this problem from two different perspectives. As a representative of the American Medical Association, I am speaking for hundreds of thousands of physicians in every type of practice across this entire Nation. But my views have also been focused and strengthened by the fact that as a practicing physician I am caring for patients and I have experienced a worrisome change in the relationship because of the liability climate.

Let me review very briefly some fundamental conclusions gained from this experience. First, there definitely is a liability crisis, there is no doubt about that. It affects doctors by forcing legal issues into medical practice. The crisis influences decisions and changes practice patterns, not always for the better. Doctors are taking earlier retirement as the crisis is literally forcing them out of their profession, whether they are actually sued or not, because of expense and psychological pressures.

Physicians are buffeted by dramatic increases in premiums, 44.8 percent in the last 2 years alone on average. Now, in New York a neurosurgeon will pay \$100,000 in premiums for only \$1 million

coverage for 1 year. This crisis affects patients in a number of ways. First, perhaps their preferred doctor has changed or limited his practice—as have one-third of the obstetricians in Florida, or 50 percent of orthopedic surgeons nationwide.

Second, the cost of liability premiums are passed on to patients, and that is very important, as well as the costs of so-called defensive medicine. And finally, beneficial but high-risk procedures might be avoided and this ends up adding to time and costs for the patients.

The crisis affects the Nation's pocketbook. The costs of medical professional liability insurance are estimated at \$11 to \$13 billion per year, of which the Federal Government pays a significant portion since the Federal Government finances 30 percent of the medical care in this country.

Recognizing this, physicians themselves have tried to solve the problem by streamlining insurance operations and advocating prompt settlement in deserving cases and stout defense of others. In addition, physicians have produced a risk management program to reduce liability or its appearance and, going a step further, physicians have formed their own insurance companies in some States.

If the problem were in the insurance industry, either in profiteering or poor management, we reasoned that physicians could solve it by forming our own companies. Unfortunately, Mr. Chairman, our experience has paralleled that of the commercial companies. Patient compensation funds and joint underwriting associations run by State government have had the same experience also.

Based on this, physicians have reached the conclusion that seems inescapable. Under current conditions, it is futile to expect a solution to the liability problem through the insurance mechanism alone. We have worked to improve this system as far as we can and we still have the problem.

We believe that to achieve insurance stability, predictability, and affordability, there has to be a change in the tort system, as you have proposed. The current system is so inequitable, expensive, and has an air of lottery to it.

Mr. Chairman, we endorse the approach of Federal incentives to States to assist them in adopting reforms, as well as improvements in risk management and medical discipline. S. 1804, with which I am sure you are familiar, introduced by Senator Hatch and others, would strike the right balance in giving Federal leadership on a problem of Federal proportions, while leaving States with the responsibility for final action. It would bring rationality and predictability into our liability system without denying the right of any patient to seek fair compensation.

Indeed, its provisions could well be applied to general liability problems as well. In brief, the bill would encourage and reward States to enact certain tort reforms and physician disciplinary procedures, and these reforms are similar to your bill, as follows:

Periodic payments on large awards, offsetting awards by amounts received from collateral sources, and capping noneconomic damages; limiting attorney contingency fees, physician discipline and mandatory risk management and reporting provisions.

Our actuaries, Mr. Chairman, predict this legislation would save 28 percent in physician premiums alone. We note that S. 2046, in-

troduced by you, is currently under consideration with certain modifications noted in our formal statement for the record. We support this bill. The bill's reform to be made applicable in Federal courts would closely parallel and would complement State reforms encouraged by S. 1804. Enactment of S. 1804 and S. 2046 in our view would produce a more favorable climate in which to compensate injured patients, improve patient care, and preserve a healthy patient-physician relationship.

We would be glad to respond to questions.

[The prepared statement of Dr. Hotchkiss follows:]

STATEMENT
of the
AMERICAN MEDICAL ASSOCIATION
Presented by
William S. Hotchkiss, M.D.

RE: The Crisis in Medical Professional Liability

March 26, 1986

Mr. Chairman and Members of the Committee:

My name is William S. Hotchkiss, M.D. I am a thoracic surgeon in practice in Norfolk, Virginia, and I am Chairman of the Board of Trustees of the American Medical Association. With me today are Betty Jane Anderson, AMA Associate General Counsel, and Harry N. Peterson, Director of the AMA's Division of Legislative Activities. The American Medical Association appreciates the opportunity to testify on the medical professional liability crisis in the United States today. We commend you, Mr. Chairman, and this Committee for holding these hearings to highlight an increasingly important national problem.

Although our testimony today will focus on the crisis facing the medical profession, we are acutely aware that medical professional liability represents only one part of an overall liability problem in this country. Our situation is unique, however, in that this is not the first time that medicine has had a professional liability crisis. Moreover, we have been experiencing an increasingly negative litigation climate for over a decade.

Physicians are in favor of proper compensation and justice for those who are injured due to the negligent or wrongful conduct of another. This nation's civil tort system has been the channel through which justice and compensation have been obtained. We believe that the basic framework of our tort liability system has in the past worked reasonably well. It is not working well today. It has become an erratic, expensive and unfair system.

Our tort system has historically had its limits. It is not designed to compensate all maloccurrences. It requires that some named individual or entity be found responsible for the injury in order to justify compensation. "Acts of God" or injuries that are entirely the fault of the plaintiff are not intended to be compensable through the civil tort process. The system, clearly, is not intended to provide compensation for all injuries or maloccurrences.

In addition to the general expansion of negligence and other theories to provide greater degrees of injury compensation, the field of medicine has the added burden of meeting increasingly high expectations from patients and their families. No one can deny the astonishing progress we have made in this country in medical diagnosis and treatment with the concomitant decreases in infant mortality, increases in life expectancy and improvement in the quality of life of many through appropriate medical intervention. By every measure, the quality of medicine in this country has never been greater. However, an unfortunate side effect of these enormously beneficial developments is an increased level of unrealistic expectations by patients. Medicine is not an exact science and a desired outcome cannot always be obtained -- even when everything is done appropriately. This nation's more than 400,000 practicing physicians have the challenge of meeting the ever-increasing medical care expectations of 240 million Americans.

Physicians are on the cutting edge of the liability problem facing the nation. New legislative solutions developed could have initial application in the field of medical professional liability. Problems that we have already experienced with increasing severity are now being faced by others. It is our view that adoption of the legislative proposals which we advocate will lead the way towards efforts to prevent the general liability problem from worsening. Medicine, however, cannot wait for all the problems of liability to be addressed. We need action now and so we urge the Congress to deal promptly and effectively with the liability issue.

THE CURRENT MEDICAL PROFESSIONAL LIABILITY CRISIS

The following facts illustrate the gravity of the current medical professional liability crisis:

health care bill. The costs of medical professional liability totaled an estimated \$11 to 13 billion in 1984. These estimates suggest that costs generated by the current liability system were responsible for between 14.5% and 17.5% of the \$75.4 billion spent on physicians' services in the United States in 1984.

It has been estimated that if the reforms advocated by the AMA were adopted, the potential annual savings would be \$800 million to \$1 billion in premium costs alone. Huge additional savings would be achieved through the reduction of the practice of defensive medicine. The federal government, which pays for nearly 30% of the nation's total health care bill, would realize major savings.

FEDERAL INCENTIVES FOR STATE HEALTH CARE
PROFESSIONAL LIABILITY REFORM

An AMA Special Task Force on Professional Liability and Insurance last year gathered data about the professional liability crisis and met with medical, legal and insurance experts. The Task Force's report constituted an action plan containing a series of recommendations in the educational, medical, legal, and legislative fields. The Task Force recommended federal incentive legislation to encourage the states to adopt substantive reforms to the tort system in order to alleviate the professional liability pressures while at the same time encouraging greater physician responsibility. This approach is intended to allow states, within general directions provided at the federal level, to develop tort reform proposals designed to meet each state's unique characteristics and needs. Out of these recommendations, an AMA draft bill was developed which formed the basis for S. 1804, a bill sponsored by Senators Hatch and Inouye and a number of other Senators. A companion bill, H.R. 3865, is pending in the House.

S. 1804 - The Federal Incentives for State Health Care Professional Liability Reform Act.

S. 1804 would provide federal incentives for states to adopt professional liability reforms. A state would be eligible to receive federal grants if the following tort reforms are adopted by the state and made applicable to cases involving health care malpractice:

1. Mandatory periodic payments for awards of future damages exceeding \$100,000.

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1. Mandatory periodic payments for awards of future damages exceeding \$100,000.

2. Reductions in awards for compensation received from other sources (eliminating collateral source rule).
3. Limiting awards for non-economic damages to \$250,000.
4. Limiting attorneys' fees to 40% of first \$50,000 of any award, 33.33% of next \$50,000, 25% of next \$100,000, and 10% of any further amounts in excess of \$200,000.

These reforms are designed to attack the problem of windfalls and would leave the fault concepts and deterrence factors in the system.

In addition, to qualify for grants a state would have to adopt the following reforms:

1. Licensing fees from health care professionals would be allocated exclusively to the state agency responsible for disciplinary actions.
2. Hospitals would be required to have risk management systems.
3. Insurance companies in the state would be required to conduct risk management programs and require physician participation as a condition of maintaining insurance.
4. Insurance companies would be required to make data concerning malpractice awards available to state disciplinary agencies.
5. State law would have to provide for expanded and protected peer review activities by state health professional societies in conjunction with their respective disciplinary boards.

Experience in states which have enacted reforms in their tort systems has shown that reforms such as those called for in S. 1804 can reduce unnecessary expenditures related to professional liability claims while providing more rapid compensation for individuals.

These reforms are discussed in Attachment A.

Other reforms.

The AMA and the medical profession are committed to weeding out incompetence. We do not, however, view incompetent physicians as the cause of the current crisis concerning professional liability. The typical medical professional liability case involves a good physician being sued for the first time. Physician incompetency is an independent problem which we believe we have an obligation to address. Physician competency and discipline can be improved, but we need the tools. The process is already in place to conduct appropriate disciplinary activities, as seen in existing hospital peer review and quality assurance programs. However, greater resources are needed and anti-trust protection needs to be conferred.

Strengthening state licensing boards. Most states have legislation which gives state health professional licensing boards effective investigative and disciplinary powers. However, these boards must have adequate resources to fulfill their functions. S. 1804 would require, as a condition of receipt of the federal grants established in the bill, (1) that states provide that licensing fees from health care professionals would be allocated to the state agency responsible for disciplinary actions and (2) that insurance companies be required to make data concerning malpractice awards available to state disciplinary agencies.

Risk Management and Peer Review. There is no evidence that the increase in the number of professional liability claims and the severity of awards are related to a decline in the quality of medical care in this country. To the contrary, the evidence is that the quality of care and skill of physicians have never been higher.

However, negligence does occur, and effective risk management and peer review can reduce it. S. 1804 would encourage states to require hospitals to have risk management systems and to require insurance companies in the state to conduct risk management programs and require physician participation as a condition of maintaining insurance.

In addition, state law would have to provide for expanded peer review activities by state medical societies. This provision in S. 1804 seeks to strengthen public and private efforts aimed at detection and discipline of physicians found to violate professional standards. The bill encourages states to provide their medical disciplinary boards with the authority to enter into agreements with the state and county medical societies to permit them to review any malpractice action, complaint or other information concerning the practice patterns of any physician. Any such agreement between the medical board and medical society would not be grounds for any civil or criminal action under the antitrust laws of the state or under federal antitrust laws. This is important, since in the past when medical societies have attempted to engage in peer review and discipline they have at times been subjected to lawsuits and liability for treble damages. Appropriate physician self-policing activities need to be protected and encouraged.

S. 2046 and S. 2038

S. 2046, the Litigation Abuse Reform Act of 1986 introduced by Senator McConnell, addresses problems related to increases in litigation in the U.S.

The reforms in the bill would be applicable in federal courts to civil actions alleging negligence, strict or product liability, intentionally tortious conduct, or professional malpractice in which damages are sought. The reforms applicable in federal courts would closely parallel certain reforms called for in S. 1804. The bill would preempt provisions of state law insofar as they are inconsistent with the reforms.

The bill would:

- o put a cap of \$100,000 on the award of non-economic damages;
- o require periodic payment of awards for future damages greater than \$100,000 on a court approved schedule;
- o eliminate the collateral source rule, thus requiring that damage awards be reduced by the amounts of any other payment;
- o clarify and tighten the standards to be used for the award of punitive damages and provide that such awards are to be paid to the U.S. Treasury;
- o limit attorney contingency fees on a declining schedule as the amount of an award increases; and
- o impose costs and/or sanctions on lawyers whose conduct is calculated for delay or is in bad faith or who has initiated civil actions without a belief in the substance of the pleading or who do not believe that there is good ground for recovery on the civil action; attorneys could be liable for up to treble costs, fees, and expenses.

This bill provides federal court reforms which would complement the state reforms encouraged by S. 1804. We believe that this bill is an appropriate adjunct to the drive to enact federal legislation to encourage state tort reforms, but we believe that the pre-emption provision should not apply where state tort reforms are more stringent than those in S. 2046. The American Medical Association supports S. 2046, with this modification. We also support the intent underlying S. 2038, to encourage the use of "alternative dispute resolution" techniques (such as mini-trials, mediation, and arbitration) in civil

actions in federal court. We are continuing our review of the bill as a whole, particularly the effect that the sanctions provided for in the bill may have on the accomplishment of the objectives of the bill.

CONCLUSION

In closing, Mr. Chairman, I again commend you for your active interest in this critical issue as shown in your holding of this hearing.

The AMA strongly supports prompt passage of S. 1804. We believe that its enactment will assist in establishing a more rational professional liability compensation system that will achieve substantial savings to the health care system (including the federal and state governments) while maintaining patient access to high quality health care.

At this time I would be happy to answer questions from the Committee.

ATTACHMENT A

Discussion of Reforms Contained in S. 1804

Periodic Payments for Future Damages. Structured settlements with periodic payments for future damages over an injured claimant's lifetime, rather than a lump sum payment, should be required. Periodic payments are less expensive to finance and they assure that financial resources will be available to an injured person over time as needed. S. 1804 also provides that payments should end if a patient dies, thus eliminating "windfall" payouts to persons other than the injured person. Cases have been reported where multimillion dollar judgments have been awarded to cover lifetime expenses of parties who die soon after the award is granted. Estimated savings of 6% in professional liability premiums alone could be realized from this reform provision in S. 1804.

Elimination of Collateral Source Rule. The collateral source rule prohibits the introduction into evidence of any information about compensation a plaintiff may receive from sources other than the defendant. Therefore, plaintiffs may receive a double, triple or quadruple recovery for the same injury -- one from an insurer or employer or other source, and one from the defendant. S. 1804 encourages states to eliminate this rule so that awards would be offset by the collateral

source recovery. Amounts spent by the plaintiff to obtain the additional compensation (such as insurance premiums) would be offset against any deduction. Estimated professional liability premiums savings of 8% could be realized from this reform provision in S. 1804.

Limit on Non-Economic Damages. Pain and suffering, mental anguish, and loss of consortium are examples of non-economic damages. These damages are impossible to ascertain accurately, can be manipulated by emotion, and are inevitably subject to speculation. They are a primary cause of the grossly distorted awards in professional liability cases. Non-economic damages should be limited. S. 1804 would provide incentives for states to limit non-economic damages to \$250,000 in health care malpractice cases. Punitive damages would also be subjected to this cap. Estimated professional liability premium savings of 12% could be realized from this reform provision in S. 1804.

In this regard it should be noted that a 1984 opinion poll published by the AMA which found that three of four Americans aged 65 and over believe there should be a limit on awards. Half say that current awards are too high, and only 23% think most suits are justified.

Restriction on Attorneys' Contingent Fees. The American Medical Association does not recommend abolition of the contingency fee system. However, a sliding scale for such fees should be established. Customarily, attorneys accept personal injury cases, as well as professional liability actions, on a contingent fee basis. The attorney may receive from 25% to 50% of any award eventually won. Injured patients on average receive less than 30% of every dollar paid by physicians for professional liability insurance. The disproportionate nature of the attorney's contingent fee is compounded by the fact that there is often no relationship between the size of such fee and the degree of complexity of the matter and amount of legal skill and time devoted to the case.

S. 1804 would encourage states to enact a sliding scale for such fees, with declining percentages paid to an attorney as the size of the award increases. This would help assure that the appropriate proportion -- i.e., the bulk -- of the award goes as compensation to the injured

party, not to the lawyers. At the same time, because of the larger percentage at the lower end of the award scale, lawyers would still be encouraged to accept cases with lower anticipated judgments. This would not, as frequently charged, deny or restrict patient access to proper remedies.

The American Bar Association, in a report on a five-year study that was issued in August, 1984, found that when lawyers reduce the amount of time spent working on a lawsuit, the savings are passed on to clients only if the clients are paying an hourly rate. When lawyers work on a contingent fee, "lawyers are benefiting," not clients, the report said.

Estimated state savings of 9% could be realized from this reform provision in S. 1804.

Senator McCONNELL. Thank you, Doctor.

Is it your judgment, Doctor, that sort of a State-by-State reform process that may or may not be under way—one of the previous panelists indicated some enthusiasm for that. In my own State, however, which has a general assembly that meets only 60 days every 2 years, they are adjourning next week and they have done nothing on this issue, so I am not at all certain that there is a wave of reform sweeping the country. There may and again there may not. Is it your judgment that some kind of more comprehensive approach to this problem may be needed?

Dr. HOTCHKISS. Absolutely. We think that the kind of approach to it as you have proposed in your bill is certainly indicated. Now, as far as your question about the States, this problem exists in every State in the country. It varies in degree in various States and, of course, the State medical societies are very concerned on behalf of their members and almost every State medical society in the country is working with others to try to see legislation enacted in the various States with varying degrees of success.

Senator McCONNELL. It would be interesting to see at the end of the year how many States have enacted some kind of tort reform. I am told that about 14 have at this point. Clearly, my State will not even deal with it in 1988, not being able to meet again until then. We have a rather unusual constitution that allows them to meet only 60 days every 2 years. I guess they thought that would insure that everybody was untouched by the general assembly.

But I am wondering what your feeling would be, let us assume that at the end of the year less than 20 States have done anything in this field.

Dr. HOTCHKISS. Mr. Chairman, it depends on how far you want to reach back in time. This problem is not new in the medical profession. We had a crisis of availability of insurance back in 1975, so we have been dealing with this problem for at least 11 years and there have been tort reforms in a number of States. Indiana and California have passed State laws including provisions similar to this and their premiums are definitely lower than in comparable States. So I am sure there are more States than that that have enacted some tort reforms, not all of these, but some of these and some others.

Senator McCONNELL. To what extent do you think the insurance companies are the problem here?

Dr. HOTCHKISS. I think that the insurance companies are sort of caught in the trap. I think that if you look at their record, you will find that they are, many of them are having a payout of 165 percent of their premium income and they can survive on some investment income if their payout is 130 or 135 percent, but when they get up in the 165 payout area they are definitely losing money. So I think that you cannot pin this problem very much on the insurance company, and I do not think you can solve this problem by addressing it as an insurance problem.

Senator McCONNELL. I have got a number of questions here I would like to submit to you, Doctor, for a response in writing for the record.

Dr. HOTCHKISS. We would be happy to respond and work with your staff and the staff of the committee.

Senator McCONNELL. Due to the lateness of the hour, I will excuse you and thank you for your patience and waiting until 12:30 to testify.

Dr. HOTCHKISS. Thank you, Senator, for holding the hearings.

Senator McCONNELL. Our final witness is Patricia Danzon, who is a consultant with the Rand Corp.

Ms. Danzon, if you would summarize your remarks, we would appreciate it.

STATEMENT OF PATRICIA M. DANZON, CONSULTANT, INSTITUTE FOR CIVIL JUSTICE, THE RAND CORP.

Ms. DANZON. Thank you. Mr. Chairman, my name is Patricia Danzon, and I am an associate professor of Health Care Systems and Insurance at the University of Pennsylvania, and a consultant to the Institute for Civil Justice at the Rand Corp.

Senator McCONNELL. Would you pull the mike a little closer to you?

Ms. DANZON. My testimony today concerns the results of three studies conducted for the Institute of Civil Justice on the factors affecting the frequency and severity of medical malpractice claims, and in particular, the impact of the tort reforms enacted in the mid-seventies.

The first study analyzed a sample of individual malpractice claims closed in 1974 and 1976. The second study used State-by-State data on the average frequency of claims per capita and the average amount paid per claim for the period 1975 through 1978. The third study used similar State-by-State data for the longer time period, 1975 through 1984.

Because these three studies used data from different time periods, the findings show slight differences but the results are broadly consistent. Before reporting the results, let me emphasize some of the difficulties involved in trying to measure the impact of the tort reforms.

First, the precise form of any given measure varied from State to State. For example, caps have been set at different levels, collateral source offset may be either mandatory or discretionary and apply to different benefits. It was only possible to estimate the average impact of each type of change.

Second, it is not possible to control for all other changes which may have occurred simultaneously, such as changes in attitudes of juries.

And third, identifying which claims could have been affected by the changes in the law is difficult because of delays in effective dates and constitutional challenges, some of which have only recently been resolved.

For these reasons the estimates, particularly from the early studies, should be viewed as measures of the short-run impact and rough indicators of the potential long-run impact of such reforms. With these caveats, let me summarize the findings for each type of tort reform.

All three studies showed that caps on awards reduce claim severity. Averaging over verdicts and out-of-court settlements, the estimated reduction is 20 to 25 percent. That is to say, awards were 20

to 25 percent lower than they otherwise would have been. That does not necessarily imply an absolute reduction of 20 to 25 percent, if there is an underlying upward trend due to inflation or other factors.

This fairly large reduction in average severity is possible, despite the fact that only a small fraction of claims would be expected to receive awards in excess of the caps, because these few very large awards account for a very large fraction of the dollars paid out. Thus capping the largest awards can have a significant impact on total dollars paid and therefore on the average payment.

In estimating the future impact of the caps, it will obviously depend on the extent to which the dollar thresholds are revised to keep pace with inflation.

The second reform which appears to have had a significant impact on severity is collateral source offset. The best estimate is about an 18-percent reduction in severity. Recall that this is the average effect of the various statutes, some of which provide for mandatory offset, while others simply admit evidence of collateral benefits. The various statutes also apply to different types of benefits. Thus statutory provision for mandatory offset of all collateral benefits would probably have a larger effect than this average effect of the statutes actually enacted.

Collateral source offset also appears to have reduced claim frequency by about 14 percent. Feedback from reduction in size of awards to reduction in number of claims filed is not surprising, since collateral source offset reduces the potential recovery for a large number of claims, particularly small claims which may consequently not be worth filing.

The other type of reform which appears to have reduced claim frequency is a statute of limitations or repose which sets an outer limit on the time allowed to sue, running from the date of the injury, not from discovery. On average, cutting 1 year off the statute of limitations for adults appears to have reduced claim frequency by about 8 percent. The reduction would presumably be greater for a reduction from, say, 4 years to 3 years for filing, than for a reduction from 10 to 9 years.

There is some evidence that statutes encouraging arbitration have increased claim frequency and reduced severity, possibly because more small claims are filed. Of the other reforms analyzed, including screening panels and limits on contingent fees, none appear to have had a consistently significant effect on malpractice claim frequency or severity.

These studies do not attempt to measure the potential impact of these tort reforms on malpractice insurance premiums. That would depend not only on the impact of the reforms on claim frequency and severity, but also on the impact on investment income, on litigation expense, and most importantly, on predictability of future losses.

Finally, these studies did not purport to provide a full evaluation of these tort reforms from a public policy perspective. The impact on claim cost is not the only relevant factor. The studies therefore do not imply any endorsement or lack of endorsement of these reforms. That concludes my summary.

[The prepared statement of Ms. Danzon follows:]

THE EFFECTS OF TORT REFORMS ON
THE FREQUENCY AND SEVERITY OF MEDICAL MALPRACTICE CLAIMS:
A SUMMARY OF RESEARCH RESULTS

Testimony Submitted by Patricia M. Danzon
To the Committee on the Judiciary, United States Senate

March 26, 1986

Mr. Chairman and members of the Commission, my name is Patricia Danzon. I am Associate Professor of Health Care Systems & Insurance at The Wharton School, The University of Pennsylvania, and a consultant to The Institute for Civil Justice at The Rand Corporation. Rand is a private, nonprofit corporation that conducts public policy research. The Institute for Civil Justice was established in 1979 within Rand and is supported primarily by corporate and foundation grants.

My testimony concerns the results of studies I have conducted for the Institute on the frequency and severity of medical malpractice claims.¹ In the late 1960s, the frequency of claims per physician and claim severity (average payment per paid claim, including jury verdicts and out-of-court settlements) began to increase at unprecedented rates, culminating in the medical malpractice crisis of the mid-1970s. In response to that crisis, legislatures in almost every state enacted tort reforms intended to curb the rise in claims, in addition to other changes designed to assure the availability of malpractice insurance.

Between 1975 and 1978, claim frequency per physician slowed or even decreased in many states, but since 1978, claim frequency has resumed an upward trend. The St. Paul Fire and Marine Insurance Company, which has been a leading writer of malpractice insurance for many years, reported a 55 percent increase in claim frequency between 1980 and 1984 -- from 10.5 claims per 100 physicians in 1980 to 16.3 in 1984.² Claim severity increased faster than the rate of inflation throughout the 1970s, and this trend appears to have continued into the 1980s. On average, over the decade 1975-1984, claim severity increased at almost twice the rate

¹ Danzon and Lillard, 1982a; Danzon and Lillard, 1982b; Danzon, 1982; Danzon, forthcoming. Danzon, 1982, was partially supported by the Health Care Financing Administration, U.S. Department of Health and Human Services. Danzon, forthcoming, was partially supported by the Urban Institute. The views expressed here are mine and are not necessarily endorsed by my research sponsors.

² *Physicians' and Surgeons' Update*, 1985, The St. Paul Fire and Marine Insurance Company, St. Paul, Minnesota.

of increases in the Consumer Price Index (CPI).³ The St. Paul reports that claim severity increased 95 percent during the five-year period 1979-1983, from \$27,408 in 1979 to \$53,482 in 1983.⁴ This average malpractice jury award is reported to have risen from \$404,726 in 1980 to \$954,858 in 1984.⁵ This upward trend in claim costs, together with the recent spate of large malpractice premium increases, has revived interest in tort reform, and hence, in the impact of the reforms enacted after the 1975 crisis. Today I shall summarize the results of three studies that provide some evidence on the impact of these reforms. Each of these studies use data from a different time period; the findings show slight differences, but are broadly consistent.

In the first study, my colleague, Lee Lillard, and I examined the disposition of some 6,000 individual medical malpractice claims closed in either 1974 or 1976.⁶ The former were disposed before most states had moved to institute reforms. The latter begin to reflect the effects of legislation enacted in response to the perceived malpractice crisis. Assessing these effects is difficult for several reasons.

First, the precise form of a given reform measure varied from state to state. For example, relaxing the collateral source rule could involve simply making evidence of collateral compensation payments admissible in court, or it could authorize deductions from the court award to avoid double payment to the plaintiff.

Second, identifying whether particular statutes could have affected claims in the data base is unavoidably imprecise. Our analysis considered only those statutes that were enacted prior to the closing date of claims in the 1976 sample. Some statutes, however, did not become effective until several months after they were enacted; claims in or near trial may have been exempted from recent changes in law; and there may have been further delays before changes in court decisions fed back into changes in out-of-court settlements.

Third, it was not possible for us to control for all of the changes being made simultaneously along with other unmeasured changes (e.g., alterations in judge-made tort law or in jury attitudes).

For all of these reasons, the effects realized in the period immediately following enactment -- the period captured by the 1976 data file -- may or may not be reliable guides to the long-term effects of each measure. Consequently, the estimates of the effects reported below were not viewed as definitive, but as rough, preliminary indicators of their apparent immediate impact. They were derived by comparing the

³ Danzon, forthcoming.

⁴ *Ibid.*

⁵ Jury Verdict Research, Inc. cited in n.2 *supra*.

⁶ Danzon and Lillard, 1982a; Danzon and Lillard, 1982b.

change in awards between 1974 and 1976 in states which enacted a particular reform during that period and in states which did not.⁷ Technical difficulties sometimes made it impossible to separate closely associated measures; in those cases, we grouped them together and arbitrarily assumed that they had equal impact. The resulting estimates should be regarded as particularly tentative.

When a state moved to cap verdicts, or to eliminate specific dollar requests by plaintiffs (i.e., bar the *ad damnum* clause), or to permit payments of awards for future losses in periodic installments, the seeming effect of any one of these changes was to:

- Cut the average settlement by 25 percent.
- Raise the portion of cases dropped from 43 to 48 percent.
- Reduce the share of cases going to verdict from 5.1 to 4.6 percent.

This analysis does not permit an accurate estimate of the cumulative effect of these measures, and the assumption that all are of equal weight is probably incorrect. Evidence from the latest studies suggest that caps on awards have greater effect than periodic payments or limits on the *ad damnum*.

Relaxation of the ban on evidence of collateral sources of compensation for the injury seemed to reduce shadow verdicts by 18 percent, but the statistical significance of this finding was quite low.

Imposition of limits on contingent fees charged by plaintiffs' attorneys seemed to:

- Cut the average settlement by nine percent.
- Raise the portion of cases dropped from 43 to 48 percent.
- Reduce the share of cases going to verdict from 6.1 to 4.6 percent.⁸

All of these results suggest that the changes enacted in the tort law during the crisis period had substantial effects, and that these effects were in the directions probably expected by the lawmakers who adopted them. It is also true that the frequency of claims and the explosion of insurance premiums -- factors largely responsible for the

⁷ This controls for the fact that states with relatively high awards in 1974 were more likely to enact changes. Assuming no such changes, they could be expected to have high awards in 1976. If we simply compared the level of awards in 1976 in states which did and did not enact changes, we would underestimate the effects of the changes.

⁸ The estimate that 6.1 percent of cases would have gone to verdict in states which limited contingent fees, compared with 5.1 percent in states enacting measures to limit awards, shows that limits on contingent fees were adopted in states with relatively high litigation rates.

sense of crisis -- abated during the years after 1976. But we emphasize that this analysis does *not* establish any necessary connection between these events: Many factors other than changes in tort law may have worked toward relieving the crisis. The evidence supports the general proposition, however, that these changes had important downward effects on settlements, verdicts, and the number of cases pressed to judgment, while tending to increase the number of claims that were dropped without payment.

In a second study, I used state-by-state data on the average number of claims closed per capita and average severity per paid claim for 1970 and 1975-1978. Information on individual claims was not available. These data were used to analyze the contribution of medical factors, demographic characteristics, and legal factors -- including tort reforms -- to the differences among states and trends over time in claim frequency and severity.

The study concluded that the increase in claims over time and the persistent diversity in experience among states could only partly be explained by such factors as the increase in the number and complexity of medical treatments and concomitant increases in exposure to the risk of iatrogenic injury.⁹ The pro-plaintiff trend in common law during the 1950s and 1960s also appears to have contributed significantly to the rise in claim frequency and severity. The other major factor contributing to the diversity among states was urbanization; however, we could not identify the specific characteristics of urban environments that generated higher frequency and severity. Differences in the number of attorneys per capita, the cost of medical services, per capita income, and unemployment rates did not appear to play significant roles.

This early analysis found mixed early effects of the tort reforms enacted in response to the 1975 crisis. Limitations on the plaintiff's recovery (caps on awards) and mandatory offset of collateral benefits appeared, by 1978, to have significantly slowed the growth in claim severity in states that enacted such changes. However, none of the other changes, such as pretrial screening panels or shorter statutes of limitations showed any impact on frequency or severity. Moreover, none of the reforms could explain, in a statistical sense, the lull in growth of claim frequency that occurred between 1975 and 1978. However, this early analysis, using data on claims closed through 1978, obviously did not purport to measure the long-run impact of the tort reforms enacted since 1975. In particular, any impact of shorter statutes of limitations on the "long tail" of claims would not then be evident. As

⁹ Danzon, 1982.

in the earlier study of individual claims closed in 1976, even the estimates of the apparent short-run effects might have been contaminated by other unmeasured factors related to the crisis, such as changes in public attitudes, which might prove short-lived.

In order to update these early estimates, I have just completed an analysis of the impact of the tort reforms and other factors on trends in malpractice claim frequency and severity, using claim experience over the full decade 1975-1984.¹⁰ The length of time since the enactment of the 1974-1977 tort reforms should now, in principle, be long enough to estimate their long-run impact. However, in practice, there are several difficulties. First, the reforms have been subject to legal challenge in many states, and final rulings either upholding or denying their constitutionality have been long delayed. For example, the California cap on awards for pain and suffering was not finally upheld in state court until early 1985 and a U.S. Supreme Court appeal failed only in October 1985. To the extent that the disposition of claims over the last decade has been influenced by uncertainty as to the ultimate outcome of these legal challenges, it may still be too early to estimate full long-run effects of those that have been upheld.

A second practical difficulty in estimating the impact of tort reforms is lack of a consistent, comprehensive data base. The medical malpractice insurance market has undergone substantial changes since 1975 in the identity of carriers and types of coverages. Several major stock insurers have withdrawn, to be replaced by physician-owned mutuals and hospital "captives" and by joint underwriting associations (JUAs). A substantial fraction of the market has also changed from an "occurrence" policy (which covers all claims arising out of medical incidents occurring in the policy year regardless of the date of claim filing) to "claims-made" coverage (which covers only claims filed in the policy year regardless of the date of injury, provided that the physician was covered by a claims-made policy with that company at the time of the injury). Although these changes in liability insurance markets are not expected to affect the behavior of patients and courts with regard to filing and disposing of claims, the large number of insurers who have had a significant market share for at least some fraction of the period under study makes collection of a comprehensive data base on claim experience very costly. The switch from occurrence to claims-made coverage further complicates the estimation of trends, particularly for claim frequency, because the number of claims reported tends to be low in the early years of claims-made coverage, rising as the policy "matures" -- even with no change in the underlying frequency of claims filed.

¹⁰ Danzon, forthcoming.

My earlier analysis of 1970's malpractice claim trends drew on a virtual census of all claims closed during 1975 through 1978, collected in a special survey by the National Association of Insurance Commissioners (NAIC). Since 1978, there has been no national compilation of malpractice claims. Data for this recent study were requested from most of the insurers with a significant market share at any time from 1975 through 1984. Several of the largest stock insurers and physician-owned companies, covering roughly 100,000 physicians, provided data in the format and detail requested. Forty-nine states are represented for at least some years. However, it remains possible that the data base may not be fully representative of the situation nationwide.¹¹

In attempting to measure the effects of various factors, including tort reform, on malpractice claims frequency and severity, I statistically compared the average experience of physicians in different states and at different points in time over the ten years, 1975-1984. As in the second study discussed above, the units of observation are not individual claims, but individual states in each year. The variables to be explained are claim frequency per 100 physicians and average severity per paid claim, by state.

To estimate the impact of a particular tort reform, one cannot simply compare the experience of State X before and after enactment because other factors may have changed over the same timespan. Similarly, one cannot simply compare, at a particular point in time, states that have enacted a particular reform and states that have not because other factors may contribute to any observed differences between states. For example, assume that State A, which enacted a cap on awards, had 20 percent higher claim severity in 1984 than State B in 1984. One should not infer that the cap had no effect because it may be that claim severity would have been 50 percent higher in A than in B had the cap not been enacted. Thus, to estimate the net impact of the cap -- or any other factor -- statistical methods are used to attempt to "control" for other factors.

The number of factors that can be controlled for depends on the number of independent observations in the sample, which determines the "degrees of freedom," and on the subset of the observations that have

¹¹ For example, data published by the American Medical Association show significant differences in claim frequency for 1983, by type of insurer. Physician-owned companies linked to medical societies reported 24 claims per 100 insured physicians in that year, compared with only 10 per 100 insured physicians for commercial companies and 11 per 100 for independent provider-owned insurers. AMA, 1984, p. 10. These differences could reflect such factors as differences in states in which the companies do business, differences in underwriting stringency, and simple differences in claim reporting practices.

the characteristic of interest. In this data base, there are observations on over 45 states in each of 10 years, but the effective degrees of freedom are less than 450 (45 times 10) to the extent that experience in successive years in any state is not fully independent of experience in the same state in prior years. This complicates measurement of statistical significance.¹² Further, it is not possible to measure the effect of each variant of each reform -- for example, a cap on pain and suffering at \$250,000, at \$100,000, and so on -- because the number of observations on each variant is too small. For most reforms, the average impact for each type of change has therefore been estimated. Two exceptions are that separate estimates were made for the effects of mandatory and discretionary collateral source offset and for different types of legislation regarding screening panels.

With these caveats, the evidence from this analysis suggests that the last round of tort reforms affected the frequency and severity of malpractice claims over the decade 1975-1984 in a manner broadly consistent with theory and previous evidence. Although claim frequency and severity have continued to rise despite reforms, this does not mean that the tort changes have had no effect. States that enacted shorter statutes of limitations and set outer limits on discovery rules have had less growth in claim frequency than states with statutes more lenient to plaintiffs. On average, cutting one year off the statute of limitations for adults appears to have reduced claim frequency by eight percent; the effect would presumably be greater for reduction from, say, four to three years than from ten to nine years.

Statutes permitting or mandating the offset of collateral benefits have apparently reduced malpractice claim severity by 11-18 percent and claim frequency by 14 percent relative to comparable states without collateral source offset. The feedback from a reduction in severity to a reduction in frequency is not surprising, since collateral source offset reduces the potential recovery for a large number of claims, so reduces incentives to file.

Caps on awards have reduced severity by 23 percent. This is the average impact of the various forms of caps over the period 1975-1984. If the dollar thresholds are not revised periodically to keep pace with inflation, the future effect will presumably be greater, unless juries find ways of implicitly circumventing the limits by increased allowances for uncapped components of the award.

Arbitration statutes appear to have increased claim frequency and reduced average severity. Disaggregated (i.e., individual claim) data is necessary to determine whether the reduction in observed average severity results from a reduction in awards per case or simply reflects

¹² This is discussed further in Danzon, forthcoming.

the filing of more small claims. The net effect appears to be an increase in total claim costs but compensation to more patients.

None of the other reforms analyzed, including screening panels and limits on contingent fees, appear to have had any systematic impact on claim frequency or severity.

Among the other factors affecting claims, urbanization remains a highly significant factor that explains much of the observed difference among states in claim frequency and severity. Per capita income, the unemployment rate, and the number of attorneys per capita have no statistically significant effects after controlling for urbanization. The surgery rate in a state increases claim frequency; the ratio of surgeons to medical specialists increases claim severity.

In summary, these three studies suggest that caps on awards and collateral source offset have significantly reduced claims severity; collateral source offset and shorter statutes of repose have significantly reduced claims frequency. These studies did not attempt to measure the effect of tort reforms on malpractice insurance premiums. That would depend not only on the effect on expected claim cost, but also on the effect on investment income and on predictability of losses. Reforms which reduce uncertainty of tort losses should reduce the volatility of price and availability of malpractice insurance.

Finally, from a public policy perspective, the goal of tort reform should not be simply to reduce the costs of claims and of malpractice insurance. Reforms should be evaluated in the broader context of the fundamental purposes of the tort system, which are deterrence of medical negligence and efficient compensation of its victims. I believe that the tort system can be made cost effective in performing these dual roles, as discussed elsewhere.¹³

¹³ Danzon, 1985.

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Senator McCONNELL. Thank you.

Ms. DANZON. I would be glad to answer any questions.

Senator McCONNELL. The General Accounting Office recently published a study on medical malpractice that suggests that changes in the law regarding liability that have been tried have been generally ineffective. Are you familiar with that report and what are your thoughts about it?

Ms. DANZON. I have not studied it in depth, but I have glanced through it. I think that those conclusions were based on discussions with various people. They were not based on any statistical analysis of the actual impact on claim frequency and severity.

Senator McCONNELL. So that is how you account for the rather significantly different conclusions?

Ms. DANZON. I think that is correct. To my knowledge, the studies that I have done for the Institute for Civil Justice are the only studies that have used statistical methods to measure the effect. There have been some attempts to obtain an actuarial estimate, which is a hypothetical or projected estimate, but I do not think that the GAO used that type of approach.

Senator McCONNELL. Have you made any assessment of the impact of the trends in medical malpractice law on consumers of medical care? Specifically have you determined the cost to consumers of increased litigation or the benefit to consumers of the presumably better medical care?

Ms. DANZON. I am speaking now not as a representative of the Institute for Civil Justice, but as an independent researcher. I have in some other research tried to estimate the costs of the malpractice system. I have looked at the fraction of total health care costs that goes to malpractice premiums. I have also given some thought to how one would try to estimate the costs of defensive medicine, and the benefits from more careful medical care.

On the question of insurance premiums, it seems that malpractice premiums probably account for roughly 2 percent of total health care costs, so it is not a very large fraction. The defensive medicine aspect of cost is much harder to estimate and I do not think that there are any good estimates that have really tried to separate out the effect of malpractice litigation from other factors affecting physician behavior.

Finally, I know of no studies that have attempted to estimate the potential beneficial effects of the malpractice system on quality of care through better risk management or simply greater care in practice.

Senator McCONNELL. What did you find with respect to contingency fee limits?

Ms. DANZON. One study found a slight downward effect of contingent fee limits on the size of settlements and a slight reduction in the number of claims settled with payment and the number of claims pursued to verdict. But the subsequent studies have not found any impact.

Senator McCONNELL. OK. I have a number of other questions that I would like to submit to you in writing. I want to thank you very much for coming.

Ms. DANZON. Thank you.

Senator McCONNELL. That concludes our series of witnesses and the hearing is adjourned.

[Whereupon, at 12:36 p.m., the committee was adjourned.]

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APPENDIX

STATEMENT OF THE NATIONAL BAR ASSOCIATION

PRESENTED BY

CARL R. EDWARDS, ESQ.

On December 30, 1903, in the City of Chicago, a new theater had recently opened. It was called the Iroquois Theater. The printed program that evening stated that the theater was "absolutely fireproof". That there were no alarm boxes, fire extinguishers or working water hoses.

On that fateful evening, a fire was accidentally started. Six hundred and two (602) people were killed as a result. Most of these were women and children. An investigation revealed that the exit doors and balcony gates had been locked in violation of city laws.

Civil lawsuits for damages were filed by the families of the victims. Approximately two dozen of the lawsuits were settled for \$750.00 per death. The overwhelming majority of the victims did not receive any compensation at all.

In 1904, an excursion boat named the General Slocum, caught fire in the East River of New York. Of the 1,500 persons aboard, 1,021 passengers died either in the flames or by drowning. Although the captain of the ship was criminally prosecuted and convicted for misconduct and negligence, the bereaved families of the victims were not able to recover anything in damages for the deaths of their loved ones in a civil court.

On April 14, 1912, 1,517 of over 2,000 passengers died when the Titanic accidentally struck an iceberg on that fateful day. Civil lawsuits were filed on behalf of the dead victims. The cases were settled, and each family received approximately \$64.45 in damages as their recovery.

And, in 1911, in what was to become one of the greatest disasters in American labor history, 145 employees of the Triangle Shirtwaist factory, died due to a massive fire, which trapped them inside because the owners had locked the doors and the only way out was by jumping out of the windows, several floors to the pavement, which over 62 people did, in an attempt to avoid being burned alive. The value of the lives of the dead was placed at \$75.00 and that was the full extent of any compensation recovered from the wrongdoers.

During the first half of the 20th century, an individual who had lost a leg or an arm, or had been severely disfigured or reduced to a wheelchair, or the family of a person killed due to the negligence of another, could expect, and did not receive more than, a few thousand dollars in damages, no matter how severe the fault of the wrongdoer.

Indeed, many cases failed to even make it to a jury. When it did, and the conscience of the community ruled in favor of the severely injured individual, the trial judge or an appellant court, reduced the judgment drastically and in some cases, overruled the jury completely. Thus the injured victim took nothing.

Historically, the insurance industry, the railroads and the captains of industry bought the best justice that money could buy. Their vast resources have allowed them to hire the best defense lawyers, with large staffs at their disposal, superior expert witnesses, the most equipped investigators and the brightest scientific brains. Collectively, they make up a virtual impenetratable army in the courtroom. Failure -- in the language of the courtroom, no cause -- is the fate that awaits all but the most courageous, determined and enterprising lawyers who dare file a case against this armada.

Who then is the entity that will take on this literal Goliath in courtroom combat? Is it another large and powerful defense law firm, with equally vast resources at its disposal? Is it a large plaintiff's law firm; cocky, elite and monied, with superior resources at its disposal?

You will probably be surprised to learn that this is not the picture at all. Studies have shown that the typical plaintiff's law firm is small, consisting of 3-5 lawyers. This typical law firm has to run on modern business principles. Due to its size and margin of profit, the laws of the market impact on it with a fury, and this makes it near impossible for the business organization to agree to take any case that offers little or no chance of recouping their investment, let alone success.

In this regard, my law office is strikingly representative of the law offices that represent injured victims of the negligence or fault of another in the community.

Our law office has 3 other lawyers. The moving force was our desire to have the freedom to run a business, to be creative and provide representation to those in our community who cannot afford to hire a lawyer and pay a retainer fee in advance and an hourly billing. In addition, approximately 25 percent of my time has been devoted to public interest work. I founded the Peoples Law School in Michigan that was a coalition effort of community block clubs, civic associations, churches, and the City of Detroit Human Rights Department. In this effort, we enlisted the support of prominent lawyers and judges who were never too busy to devote precious hours of their time away from their families and businesses, to educate and in turn, get feedback from members of the community.²

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Indeed, of the approximately 3,500 lawyers in the State of Michigan whose livelihood is made and sustained by injured victims of another's negligence, 95% are small law offices.

²I have been informed that the United States Navy and various Bar Associations across the nation, have adopted the concept of the Peoples Law School.

For 13 years, I have lived the regimen that this lifestyle required. There have been no yachts. There have been no golf outings, weekly or monthly. Indeed, in this entire time, I have yet to find time to take a vacation.

The personal sacrifices have been great. Because a lawyer representing the average American, who has been victimized by the negligence of another, has little time for distractions. He or she must be not only lawyer to his injured client, but father, friend and confidant. Why do we do it? The reason lies in the reward. Monetary and material you say? Hardly! There are any number of ways to make money and have an easier time of it. Indeed the most obvious would be to become a lawyer for the rich and powerful.

Simply put, the ultimate reward is satisfaction in the work we do. You will never know the tears of joy that are etched on the face of an individual who has felt conscious pain and suffering. An individual who, from the moment you meet him, you could discern the fear and trepidation of being thrown out of work due to a foreseeable injury on behalf of the wrongdoer. To see this once proud family man or woman, reduced to tears, from their agony, or that group of individuals who carry their burden and their pain and weep silently. The total helplessness of that individual becomes the burden of his or her lawyer as well.

A recent case in my law offices will illustrate the point. Four years ago, Robert and his wife came into my office. For no apparent reason, Robert had, without warning, gone blind. A friend of his had referred his wife to us. They thought he had a workers compensation case.

After investigating the case and receiving medical records, we found, to our amazement, that in 1978, Robert had gone blind as a result of a brain tumor. Further, that x-rays had shown this to be the case as early as 1970, eight years earlier. Incredibly, this man's doctor, one of the top neurosurgeons in Michigan, had not performed, nor ordered the test that could diagnose the brain tumor. Nor did he perform the necessary follow-up care. The result was that the tumor grew as large as a ball in Robert's head over 8 years. And, although he did not die, he was blinded for life, his pituitary and hormone system was destroyed and he was devastated emotionally.

Robert had been married for over 20 years and had 5 children. He had worked for over twenty years with the City of Detroit. This mistake by the doctors, did not cost him earthly life, but it certainly cost him life as he and his family had formerly knew it.

When we discovered the negligence, did the insurance company settle? No. They hired the best lawyers and staff money could buy. We found ourselves in a fight for Robert's life and our legal life.

Although the care of this man was contrary to all the literature in scientific and medical journals and medical school textbooks, the insurance company still fought us. They enlisted the Dean of the state's largest medical school to testify for the neurosurgeon. They retained the chief of the radiology department of the largest medical hospital in Michigan, to testify on their behalf. We had to go all the way to Arizona and Wisconsin to find an expert to testify in accordance with the acceptable standard of care, because no physician in or near Michigan, with any credibility, would risk testifying against a colleague.

And in a move that was questionable ethically, the month before the trial was scheduled to begin, our expert neurosurgeon sent us a letter withdrawing from the case because the medical director at the hospital where he works had threatened his association with the hospital if he did not discontinue his relationship with us!

Fortunately for our client, our tireless preparation paid off, for the case was settled the day of trial. In this case, which was taken on a contingency fee, we had to finance the entire lawsuit out of our own funds, because our client and his family had been reduced to social security disability pension benefits by his permanent injuries. The total cost that we spent before we received one dime was \$45,000.00! In effect, we had to lend our client \$45,000.00 in order to file and sustain his cause of action for his horrendous injuries which were the result of a doctor's gross negligence.

Was it simply the money that motivated the discovery and filing of this lawsuit? I think not. Rather, it was the near impossible challenge and the sheer intangible feeling that after it was over, but for our labors, our creations, the blatant negligence which produced the devastating injuries here would have gone undetected and unchallenged. Robert and his family would have been a burden on the taxpayers for the remainder of his life -- he was 54 at the time of settlement, blind, on replacement hormone therapy, and pain reduction for the remainder of his life.

Our office and every lawyer who represents injured people as a result of someone else's negligence, could pull horror story after horror story from their files. But as awful as are these human tragedies that we deal with on a daily basis, for our purposes here, we used them only to illuminate one point. Who speaks for the hundreds of thousands of victims and their families in this debate in the alleged national liability insurance crisis?

A United States Senator is by law, duty bound to represent all of the citizens not merely those that divine providence has endowed with the advantages of wealth and privilege.

Senate Bill S.2046 is therefore a seriously flawed approach to identifying and resolving this purported crisis. In one full sweep, it undermines and does violence to traditional Constitutional rights and principles. It ignores and obliterates decades of solid judicial authority, which is a product of the common law. ~~and~~ Unmasked in its most naked form, it heaps new privileges on a special interest lobby, to the detriment of the health, safety and welfare of the community as a whole, all the while convincing its victims that it is in the national interest.

Senate Bill S.2046 is not only unwise, it is bad legislation. Without conducting one iota of impartial, balanced, investigation, it recommends radical, indeed, revolutionary reforms. For surely the pied pipers of industry and finance would vigorously oppose identical legislation if it sought to restrict their profits and potentially brought their businesses to ruin and placed limits on the fees that defense attorneys could charge, as a taking of property without due process and in restraint of trade and therefore constitutionally infirm. Moreover, this legislation would be condemned by Senator McConnell, who introduced it and others as undemocratic and contrary to our freedoms if the shoe were on the other foot, no doubt.

The introduction of S.2046 by Senator McConnell is most certainly not the finest hour of the United States Senate. But

our republic has known dark days in times gone past and has found the will and wherewithal to persevere.

For those who truly believe that the interest of concentrated wealth and power needs the special protection that this proposed legislation affords, I would recommend that the approach taken by the Governor of the State of Michigan, James Blanchard, be pursued before they unthinkingly pass judgment on such important legislation.

In 1984, the special interest insurance and manufacturer's lobby began a concerted campaign to get legislation introduced and passed, creating additional rights and privileges to the detriment of injured and future victims of the negligence of others.

The Governor appointed an investigator, Mr. Robben Fleming, former President of the University of Michigan, to study the facts in the area of medical malpractice (See attached Exhibit T). The following is a summary of his findings:

"In a study involving all claims filed against all physicians between 1976 and 1984 who were insured by the three currently active insurers of physician malpractice in Michigan, data compiled by the Office demonstrate that, both in the aggregate and by specialty, a small, though substantial, number of physicians account for a large number of claims. The methodology employed was extremely conservative and almost certainly understates this effect. Despite this, the following results emerge. For all claims and all physicians, 0.2% of all physicians accounted for 3.4% of all claims, 2.5% of all physicians accounted for 19.7% of all claims, and 19.3% of all physicians accounted for 72.2% of all claims. Further, 58.1% of all physicians had no claims at all.

"One's first reaction to these startling findings is to assume that this reflects the increased likelihood that the comparatively few physicians in the so-called high-risk specialties will have disproportionately more claims lodged against them, and that it is to be expected therefore that most claims will be lodged against a relatively small number of physicians. But this turns out not to be the case. A pattern similar to that described above appears to hold within each specialty, as well as for physicians as a whole.

Thus, for example, among physicians who are in general/family practice and internists who perform no surgery, 0.8% of these physicians accounted for 10.7% of claims and 10.6% of these physicians accounted for 62.9% of claims. Among general surgeons, 5.4% accounted for 20.8% of claims. Among obstetricians, 0.9% of physicians accounted for 5.7% of claims and 8.8% accounted for 30.5% of claims. Among the so-called high-risk specialty physicians, 1.1% of physicians accounted for 6.9% of claims and 11.1% accounted for 40.0% of claims.

These findings seem to point to certain fundamental conclusions with respect to malpractice. While the study focuses only on claims filed, as opposed to closed claims, it seems quite likely that the pattern of filed claims is a reliable rough indicator of the pattern of claims which have a legitimate basis. To

the degree that this is so, there can be little doubt that a very large part of this problem is concentrated in a comparatively small part of the physician community.

In addition, these findings cast doubt on the argument that the present problem is largely a consequence of the growth of 'frivolous' claims. If it were the case, for example, that the public has come to regard the medical liability system as a 'lottery', then one would expect that the filing of claims would be spread much more evenly among physicians. It is difficult to understand why, if the filing of a claim generally has little to do with the commission of an underlying negligent act, that claims are concentrated against such a small number of physicians. To put the point otherwise, if the filing of claims are 'random' events which are unrelated to the actual incidence of malpractice, why are the claims concentrated this way?

"Finally, these findings are quite significant because they demonstrate that, within both high and low risk specialties, there are specific physicians who tend to be the objects of malpractice claims. While this subject requires a very great deal more investigation, it is possible to hypothesize that most members of this group are physicians who are generally competent, but who are, in some sense, error-prone. Given the large proportion of claims attributable to this group, it is clear that there is a need to focus carefully on what might be done to deal with this phenomenon.

"The third group described above consists mainly of physicians with respect to whom there is no doubt as to their competency and as to the generally high level of care which they take in providing services to patients. It may well be that there is, in practical terms, an irreducible minimum amount of malpractice which we must be prepared to accept and which is to be accounted for in terms of the normal failings of human beings.

"To the degree that the present 'crisis' is a function of the amount of malpractice which actually occurs, it is possible to make substantial progress towards resolving the 'crisis' by reducing the incidence of malpractice. In particular, the second and third of the groups which are identified above, which comprise our supply of competent physicians, would benefit greatly from a serious, sustained effort to identify and remedy those specific behaviors which lead to errors and accidents. Effective techniques for doing this exist.

"In this connection, it appears that with the possible exception of the state's principal malpractice insurer for hospitals, virtually no effort to undertake serious and effective risk management and loss prevention activities has been made in this state. Neither the companies which insure physicians nor the medical community itself has, up to now, seemed to recognize the value of, nor exhibited a willingness to commit the resources to, such an effort. Yet, this as an essential part of the solution to this problem." (emphasis added Fleming Report pp. 11-12 (December 17, 1985))

In passing on the propriety of this new, revolutionary legislation embodied in S.2046, members of this committee must bear in mind at all times, that one of the great purposes of the tort law as it has been developed and fashioned in America, is not only compensation for the victim, but equally important is deterrence. That is, by making it too costly to produce a product or service in an unsafe way. To further illustrate this point, In Funk v General Motors Corp, 392 Mich 91,104, the Court stated, "The policy behind the law of torts is more than compensation of victims. It seeks also to encourage implementation of reasonable safeguards against risks of injury."

It was just a few years ago that Ford Motor Company produced an unsafe automobile, the Pinto. committee members will recall that the decision makers at Ford refused to put a device on this car, between the gas tank and the bumper, that would prevent the gas tank from exploding and creating a literal hell on earth for the trapped, unsuspecting victims inside the automobile. This part only would have cost the manufacturer seven (7.00) dollars, but it was not produced because decision-makers at Ford calculated they would pay out less in settlement and jury verdicts to the victims and families of these foreseeable and preventable injuries. It was only the deterrent effect of the tort system which finally made public these disclosures and forced correction by this automobile manufacturer. No government regulation or Congressional law was needed.

This dynamic operates everyday saving the lives of thousands of individuals and it prevents millions of foreseeable injuries. Indeed, Dr. Fleming had this to say in his special report to the Governor regarding the deterrent effect of the tort law:

"Finding 2: The current climate with respect to medical liability has had a substantial impact on the ways in which health care services are provided to patients. While many of these effects are clearly undesirable, some are not. It is important to keep in mind that the concept of medical liability, by creating a deterrent to unacceptable health care practices, makes a contribution to the maintenance of high standards of quality for health care." (emphasis added) Id. at 1

In conclusion, on behalf of the National Bar Association, its members, families, friends and the millions of individuals injured and maimed each year, and on behalf of the families of those individuals killed each year, because of the culpable negligence that was foreseeable, we respectfully, although absolutely, oppose S.2046.

This proposed legislation discriminates against the majority of the people of America and favors the concentrated wealth and privileged interest in our society. It is unwise and fraught with mischief. it is destructive to the best traditions and values we, who love freedom, cherish and hold dear. We respectfully request that the Senate Judiciary Committee reject it as dangerous to our republic.

STATEMENT
OF THE
NATIONAL MEDICAL ASSOCIATION

Concerning:
Professional Liability Insurance
Reform Legislation

Presented by:

John E. Joyner, M.D.
Chairman, Board of Trustees
National Medical Association

As Chairman (Dr John E. Joyner) of the Board of Trustees of the National Medical Association, let me express my appreciation to you and to the Committee for holding hearings and sustaining the Nation's attention on the liability insurance crisis.

The National Medical Association was founded in 1895 by Black physicians in an era of general hostility toward Black professionals. Unwelcomed in the national body of physicians, this Association was founded to encourage the professional development of minority physicians in the interest of better health care for all Americans. Today, the Association is still serving the interest of the more than 13,000 minority physicians and their patients, particularly the doctors who serve and the patients who live in the inner city community.

As we see it, the long-term prospects for achieving quality health care parity in Black communities is exceedingly bleak if no effective action is taken to stem the ever-rising cost of malpractice insurance.

The magnitude of this high cost of liability insurance problem is difficult to overstate. The Nation is watching in bewilderment as some doctors are seriously considering permanently closing their practices or are moving to areas of less costly malpractice insurance, while others are actually picketing government offices in attempts to force a solution to the problem of inordinate cost for liability coverage.

Quality Health Care Considerations for Inner City Practitioners

Just as resort operators (mentioned in the March 24, 1986 issue of TIME

Magazine) have raised ski-lift charges by \$2 to \$3 per ticket due to the increased costs of liability insurance coverage, physicians too, must cover the risk protection cost of their operations. It is axiomatic that physicians' fee structures must be adjusted upwards to help shoulder the weight of liability insurance that has increased by more than 200% over the past ten years and about 45% in the last two years.

Obviously, depending on the economic well-being of their clientele, the margin for fee adjustment flexibility is greater for some physicians than for others. This elementary fact of economic life adds yet another very serious threat to the long-term goal of raising the level of health care in inner city communities. Only so many obstacles will continue to be overcome by Black doctors who are now attracted to their "home" areas.

The outrageous costs of liability insurance is gradually doubling or tripling the odds against the maintenance of a reasonably stable inner city medical practice. Where will these already very vulnerable physicians turn when they have reached their limits in reducing the costs of maintaining their offices?

Quality health care considerations, in addition to the necessity of utilizing defensive medicine practices, demand more than mere cursory attention to a patient's needs. A wife or child may help in the office, but there are limits to overhead costs reductions.

The professional development outlook is anything but bright for an inner city physician already faced with a \$100,000 debt for medical training; the prospects of \$20,000 to \$120,000 (depending on location and specialty) a year in liability insurance premiums; and, a patient base of sicker people with multiple health problems. These kinds of demands will surely drive more and more doctors away from areas where they are most needed.

Encouraging the States to Institute Professional Liability Reform

Of the solutions to the professional liability insurance problem presently pending in the House and Senate, we support the "federal incentives for state law reform" approach. We recognize that, for the most part, our Nation's insurance industry, and its Tort Law Systems are governed by rules and regulations of the state governments. No doubt, at this point,

it is politically improbable that any serious consideration will be given to establishing federal dominance in the governance of the commercial and professional liability insurance industry, including rate-setting and disputes resolution. Yet it is undeniable that the impact of the liability insurance problems raised are national in their geographic and economic scope.

Moreover, a fair solution would reform the liability insurance industry's rate-setting, investments, and accounting practices as well as reform the tort system and professional practices of the insured. Regrettably, it seems that battle must be fought on another day. So we go on record in support of the limited and more cumbersome solution of encouraging the individual states to enact tort law and professional discipline reforms, knowing that a culpable party, the insurance industry, is likely to escape judgment.

Federal legislation which embody the "incentives for state action" approach are H.R. 3865 and S. 1804. Equally acceptable solutions are offered in H.R. 1370, H.R. 386, and S. 1960. Each of these require Federal intervention for encouraging state law and procedural reforms.

The H.R. 3865 and S. 1804 proposals offer federal grants to states that would adopt specific tort law and other reforms:

1. Limiting courts awards for non-economic damages to \$250,000.
2. Lessen the impact of or eliminate the collateral source rule by reducing compensation awards from other sources.
3. Requiring periodic payments for awards of future damages exceeding \$100,000.
4. Scaling attorneys' fees to 40% of the first \$50,000 of an award, 33.33% of the next \$50,000, 25% of the next, and 10% of further amounts in excess of \$200,000.

Federal grant recipients must also allocate health care professionals licensing fees exclusively to state agencies responsible for disciplinary actions. Insurance companies in these states would be required to conduct risk management programs that are mandatory for physicians if they are to retain their insurance coverage. The insurer would also be required to supply malpractice awards data to state disciplinary agencies.

In addition, states that would receive federal incentive grants must

require hospitals to establish risk management systems, and the states themselves must expand peer review activities.

This may not be the proper forum for raising problems associated with greater peer policing in the physician community, but suffice it to say that peer review standards must be clearly objective in their establishment as well as in their application to particular cases. We urge that federal incentives require the states to demonstrate that good-faith-efforts have been undertaken to utilize Black and other minority health providers on peer review councils.

Other Legislative Solutions

From our perspective, congressional legislation such as S.2046 is more appreciated for the needed attention it brings to this critical issue than as a comprehensive solution to the problems raised. S. 2046 is supportable as far as it goes. It is, however, more limited in scope than S. 1804.

We see S. 2046 as a necessary first step in establishing a more desirable body of federal tort law that would supplant state tort law in the federal courts. In the main, it is recognized that the federal courts are not where the action is on personal injury issues. As matters now stand and if S. 2046 is enacted, plaintiffs would have every reason to avoid trying their claims at the federal level. Forum shopping would certainly be encouraged.

Conclusion

We strongly support passage of any one or combinations of S. 1960, S. 1804, and H.R. 3865, and H.R. 386 as politically feasible solutions to physicians' malpractice insurance problems that pose even higher risks for quality health care in inner city communities. We are equally strong in our recommendation that state peer review panels be required to show proof of their efforts to utilize the services of Black and other minority health professionals.

We cannot conclude this statement without again offering our thanks to the Senate Judiciary Committee for this opportunity to present our views, and for the Committee's aggressive interest, as demonstrated by the recently held hearings, in fashioning a workable solution for unraveling the knot of problems that may strangle determined efforts to afford every American fair access to health care that is uncompromising in scope and quality.

99TH CONGRESS
2D SESSION

S. 2038

To amend the Federal Rules of Civil Procedure regarding dispute resolution.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 3 (legislative day, JANUARY 27), 1986

Mr. McCONNELL introduced the following bill; which was read twice and referred to the Committee on the Judiciary

A BILL

To amend the Federal Rules of Civil Procedure regarding
dispute resolution.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 This Act may be cited as the "Alternative Dispute Resolu-
4 tion Promotion Act of 1986".

FINDINGS AND PURPOSE

6 SEC. 2. (a) The Congress finds and declares that—

7 (1) the traditional litigation process is unsuited to
8 the timely, efficient, and inexpensive resolution of dis-
9 putes among businesses and individuals involved in
10 civil disputes;

(2) alternative dispute resolution techniques, including mini-trials, mediation, and arbitration offer more cost-effective resolution of such disputes and contribute to efficient use of resources in the Nation's economy; and

(3) the Federal Government has an interest in encouraging the use of such alternatives to the civil litigation process, to increase efficiency in interstate commerce, and to not impede economic output with prolonged litigation.

(b) It is the purpose of this Act to encourage the use of such alternative dispute resolution techniques, and to encourage the disposition of civil disputes in the most economic and efficient manner possible.

ALTERNATIVE DISPUTE RESOLUTION OPTIONS

SEC. 3. (a) The Federal Rules of Civil Procedure are amended by inserting between Rule 16 and part IV, the following:

"Rule 16.1. Advice and Certification by Counsel

"(a) ALTERNATIVE DISPUTE RESOLUTION OPTIONS.—At any time after 90 days and before 180 days after service of the summons, each attorney who has made an appearance in the case and who represents one or more of the parties to the action shall, with respect to each party separately represented, advise the party of the existence and availability of alternative dispute resolution options, including

1 extra-judicial proceedings such as mini-trials, and third party
2 mediation, court supervised arbitration, and summary jury
3 trial proceedings.

4 “(b) Notice. Each such attorney shall, not later than
5 180 days after an action is commenced, file notice with the
6 court certifying that the attorney has so advised his client or
7 clients, and indicating whether his client will agree to one or
8 more of the alternative dispute resolution techniques.

9 “(c) Order by the Court. In the event all parties to an
10 action agree to proceed with one or more alternative dispute
11 resolution proceedings, the court shall be notified of such ac-
12 ceptance of such offer and shall enter an appropriate order
13 governing the conduct of such alternative proceedings. En-
14 tering an order governing such further proceedings shall con-
15 stitute a waiver by each party subject to the order of the
16 right to proceed further in court.

17 “(d) Decision Inadmissible. Neither the acceptance nor
18 the refusal of any party to the action to engage in such alter-
19 native dispute resolution proceedings shall be admissible as
20 evidence in any further proceedings in such action. In the
21 event an offer made pursuant to this rule is rejected, the
22 court shall proceed with the action as if no such offer had
23 been made.”

24 PROCEDURE FOR ALTERNATIVE DISPUTE RESOLUTION

25 SEC. 4. (a) Rule 68 of the Federal Rules of Civil Proce-
26 dures is amended to read as follows:

1 "Rule 68. Offer of Settlement and Alternative Dispute
2 Resolution

3 "(a) Offer of Resolution. At any time more than 60 days
4 after the service of the summons and complaint, but not less
5 than 90 days (or 75 days in the case of a counter-offer) before
6 trial, any party may serve upon any other party, but shall not
7 file with the court, a written offer to—

8 "(1) settle a claim for such money, property, or
9 other relief as the offeror shall specify in the offer, and
10 enter into a stipulation dismissing the claim; or

11 "(2) allow judgment to be entered accordingly.

12 Alternatively, or in conjunction with such offer, any party
13 may serve upon any other party an offer to engage in such
14 extra-judicial alternative dispute resolution techniques as the
15 offeror may desire, or such judicially supervised alternative
16 dispute resolution techniques as are available in the court in
17 which the action is pending. The offer shall remain open for
18 60 days unless a written withdrawal is served on the offeree
19 prior to acceptance by such offeree. An offer that remains
20 open may be accepted or rejected in writing by the offeree.
21 An offer that is neither withdrawn nor accepted within 60
22 days shall be deemed rejected. The fact that an offer is made
23 but not accepted does not preclude a subsequent offer. Evi-
24 dence of an offer is not admissible except in proceedings to
25 enforce a settlement or to determine sanctions under this
26 Rule.

1 “(b) Sanctions for Delay. If, upon a motion by the of-
2 feror within 10 days after the entry of judgment, the court
3 determines that an offer of settlement or an offer to engage in
4 alternative dispute resolution was rejected unreasonably, re-
5 sulting in unnecessary delay and needless increase in the cost
6 of the litigation, it shall impose an appropriate sanction upon
7 the offeree. In making such determination the court shall
8 consider all the relevant circumstances at the time of the
9 rejection, including (1) the then apparent merit or lack of
10 merit in the claim that was the subject of the offer, (2) the
11 closeness of the questions of fact and law at issue, (3) wheth-
12 er the offeror had unreasonably refused to furnish information
13 necessary to evaluate the reasonableness of the offer, (4)
14 whether the suit was in the nature of a test case, presenting
15 questions of far-reaching importance affecting non-parties, (5)
16 the relief that might reasonably have been expected if the
17 claimant prevailed, and (6) the amount of the additional
18 delay, cost, and expense, including the additional attorney
19 fees, that the offeror reasonably would be expected to incur if
20 the litigation should be prolonged.

21 “(c) Guidelines for Sanctions. In determining the
22 amount of any sanction to be imposed under this Rule the
23 court also shall take into account, (1) the extent of the delay,
24 (2) the amount of the parties’ costs and expenses, including
25 any reasonable attorney fees incurred by the offeror as a

1 result of the offeree's rejection, (3) the interest that could
2 have been earned at the prevailing market rates on the
3 amount that a claimant offered to accept, to the extent that
4 the interest is not otherwise included in the judgment, and (4)
5 the burden of the sanction on the offeree. Unless the court
6 specifically finds that such burden so far outweighs the other
7 circumstances, including the interests of encouraging settle-
8 ments and avoiding needless and protracted litigation that are
9 sought to be furthered by this Rule, the court shall impose a
10 sanction in an amount not less than the added court costs and
11 fees incurred as a result of the failure by the offeree to accept
12 the offer that is the subject of the motion.

13 “(d) Exception. This Rule shall not apply to class or
14 derivative actions under Rules 23, 23.1, and 23.2.”.

15 (b) The table of Rules for the Federal Rules of Civil
16 Procedure is amended by—

17 (1) inserting between the item relating to Rule 16
18 and part IV, the following:

19 **“16.1. Advice and Certification by Counsel**

20 “(a) Alternative Dispute Resolution Options.

21 “(b) Notice.

22 “(c) Order by the Court.

23 “(d) Decision Inadmissible.”.

24 (2) amending the item relating to Rule 68 to read as
25 follows:

1 "68. Offer of Settlement and Alternative Dispute Resolu-

2 tion

3 "(a) Offer of Resolution.

4 "(b) Sanction for Delay.

5 "(c) Guidelines for Sanctions.".

To provide limits and procedures in certain civil cases.

Mr. McCONNELL introduced the following bill; which was read twice and referred to the Committee on the Judiciary

To provide limits and procedures in certain civil cases.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,
This Act may be cited as the "Litigation Abuse Reform Act of 1986".

6 SEC. 2. (a) The Congress finds and declares that—

7 (1) there are serious problems with litigation in
8 the Federal courts, and with the system under which
9 tort claims are filed and resolved;

10 (2) the cost of litigation over the past 25 years
11 has risen at a dramatic rate, and threatens to continue
12 to rise at a similar rate for the foreseeable future;

1 (3) the size of judgments awarded in tort litigation
2 has increased far beyond a reasonable or desirable
3 level, and has far exceeded the level of awards reason-
4 ably necessary to compensate victims of accidents or
5 injury for the economic loss they have incurred;

6 (4) the cost of litigation and the size of settle-
7 ments and judgments in tort litigation have direct and
8 undesirable consequences on interstate commerce, and
9 on the availability of products and services nationwide;

10 (5) the uncontrolled increase in the size of settle-
11 ments and awards for damages in litigation has created
12 a crisis in the insurance industry nationwide, with nec-
13 essary insurance unavailable at costs reasonably afford-
14 able by consumers;

15 (6) there is a need for reasonable limits on the po-
16 tential exposure for individuals and businesses to liabil-
17 ity for damages resulting from the sale of products, the
18 provision of services, or the ownership of property, all
19 of which contributes to the net economic output of the
20 Nation's economy, and to the general welfare; and

21 (7) the civil justice system and substantive tort
22 law is unable to provide just compensation to deserving
23 claimants without threatening to inflict grievous and
24 lasting injury on the economy, thereby diminishing the

1 general welfare of the Nation and of the several
2 States.

3 (b) It is the purpose of this Act to limit the amount of
4 damages awarded for injuries, and to provide changes in the
5 tort system consistent with the need for restraint and uni-
6 formity in the use of litigation to provide compensation for
7 accident or injury.

8 LITIGATION ABUSE REFORM

9 SEC. 3. (a) Part V of title 28, United States Code, is
10 amended by adding at the end thereof the following new
11 chapter:

12 **"CHAPTER 135—LIMITATIONS AND PROCE-**
13 **DURES REGARDING CIVIL DAMAGES**

"Sec.

"2121. Applicability.

"2122. Periodic payments.

"2123. Application of collateral source benefits.

"2124. Limitation on damages for noneconomic losses.

"2125. Limitation on contingency fee agreements.

"2126. Limitation on awards of punitive damages.

"2127. Counsel's liability for excessive costs.

14 **"§ 2121. Applicability**

15 "(a) This chapter applies to any civil action, in any
16 court of the United States, alleging negligence, strict or prod-
17 uct liability, intentionally tortious conduct, or malpractice by
18 a physician, accountant, lawyer, architect, engineer, or other
19 professional, in which damages for physical injury or physical
20 or mental pain or suffering are sought.

1 “(b) This chapter preempts State law relating to such
2 civil actions only to the extent that this chapter establishes a
3 rule of law applicable to such action. Any issue arising in
4 such an action that is not governed by such rule of law shall
5 be governed by applicable State or Federal law.

6 “§ 2122. Periodic payments

7 “(a) In any civil action to which this chapter applies, if
8 the court awards an individual future damages in excess of
9 \$100,000—

10 “(1) the payment of such future damages shall be
11 made in such amounts and at such intervals as deter-
12 mined by the court, over a scheduled period of time or
13 over the estimated lifetime of such individual;

14 “(2) such payments shall be made until the total
15 amount of such award is paid to such individual, except
16 that if such individual dies prior to the date on which
17 the final payment is to be made, the party obligated to
18 make the payments shall not be required to make any
19 additional payments to the heirs or assigns of such in-
20 dividual unless directed to do so by the court; and

21 “(3) the court shall require that such periodic pay-
22 ments be made through the establishment of a trust
23 fund or the purchase of an annuity.

1 **"§ 2123. Application of Collateral Source Benefits**

2 “(a) In any civil action to which this chapter applies, the
3 total amount of damages awarded to an individual shall be
4 reduced, pursuant to the provisions of subsection (b), by any
5 other payment which has been, or will be made to such indi-
6 vidual to compensate for the same injury sustained as a result
7 of the conduct of the judgment debtor under—

8 “(1) a Federal or State disability or sickness pro-
9 gram;

10 “(2) a Federal, State, or private health insurance
11 program;

12 “(3) an employer wage continuation program; or

13 “(4) any other source of payment intended to
14 compensate such individual for such injury.

15 “(b) The amount by which an award of damages to an
16 individual for an injury shall be reduced under subsection (a)
17 shall be an amount equal to—

18 “(1) the total amount of any payments which have
19 been, or will be made to such individual to compensate
20 such individual for such injury, minus

21 “(2) the amount paid by such individual to the
22 spouse, parent, or guardian of such individual to secure
23 the right to the payments described in subsection (a).

24 **"§ 2124. Limitation on damages for noneconomic losses**

25 “(a)(1) Notwithstanding any other provision of law, in
26 any civil action to which this chapter applies, the amount of

1 damages for noneconomic losses resulting from the conduct of
2 the judgment debtor shall not exceed \$100,000.

3 “(2) For purposes of this subsection, the term ‘noneco-
4 nomic losses’ means losses for pain, suffering, inconvenience,
5 physical impairment, disfigurement, and other nonpecuniary
6 losses.

7 “(b) Notwithstanding any other provision of State or
8 Federal law regarding joint or several liability, a judgment
9 debtor shall be liable only for that portion of an award for
10 noneconomic losses for which the judgment debtor is individ-
11 ually responsible, as determined by the trier of fact.

12 **“§ 2125. Limitation on contingency fee agreements**

13 “(a) Except as provided in subsection (c), in any civil
14 action to which this chapter applies and in which the plaintiff
15 receives a settlement or an award of damages, the amount of
16 payments to the plaintiff’s attorney or attorneys shall be de-
17 termined pursuant to this subsection. If the total award or
18 settlement is—

19 “(1) not more than \$50,000, the attorney’s fee
20 shall not exceed 35 percent of such amount;

21 “(2) more than \$50,000 but less than \$100,000,
22 the attorney’s fee shall not exceed \$17,500 plus 30
23 percent of the excess over \$50,000;

1 “(3) more than \$100,000 but less than \$200,000,
2 the attorney’s fee shall not exceed \$32,500 plus 20
3 percent of the excess over \$100,000; or

4 “(4) equal to or greater than \$200,000, the attor-
5 ney’s fee shall not exceed \$52,000 plus 10 percent of
6 the excess over \$200,000.

7 “(b) Notwithstanding the provisions of this section or
8 any other provision of law, no award of punitive damages
9 shall be included in the computation of the total settlement or
10 award to a plaintiff for purposes of awarding an amount of
11 attorney fees.

12 “(c)(1) Notwithstanding the provisions of subsection (a),
13 in any civil action involving multiple claims, product liability,
14 or personal injury, or in any civil action which has been certi-
15 fied as a class action pursuant to Rule 23 of the Federal
16 Rules of Civil Procedure, the court shall, within 90 days
17 after the action is commenced or is certified pursuant to Rule
18 23, make a determination regarding the likelihood of a sub-
19 stantial settlement, or an award of damages to the plaintiff in
20 excess of \$500,000. If the court determines that such a sub-
21 stantial settlement or award of damages is more probable
22 than not, the amount of payments to the plaintiff’s attorney
23 or attorneys shall not exceed 10 percent of the total amount
24 of the settlement or award, exclusive of interest.

1 “(2) In making a determination pursuant to paragraph
2 (1), the court shall consider—

3 “(A) the nature and extent of the injuries com-
4 plained of;

5 “(B) the alleged cause of and circumstances sur-
6 rounding the injury;

7 “(C) the likely economic loss in light of the plain-
8 tiff’s customary occupation and level of skill, education,
9 or training;

10 “(D) the law applicable to the cause of action, in-
11 cluding the applicability of available legal defenses; and

12 “(E) whether there is a single defendant or multi-
13 ple defendants, and whether any potentially liable
14 party is unknown, insolvent, or beyond the jurisdiction
15 of the court.

16 “(c) The determination by the court regarding the likeli-
17 hood of a substantial settlement or award of damages in
18 excess of \$500,000 shall not be subject to review in any
19 court, by appeal or otherwise, whether by interlocutory
20 motion or upon entry of a final judgment or order.

21 **“§ 2126. Limitation on award of punitive damages**

22 “(a) Notwithstanding any other provision of law, puni-
23 tive damages shall not be awarded to any plaintiff in any
24 action to which this chapter applies unless the plaintiff estab-
25 lishes by a preponderance of the evidence that the harm suf-

1 fered by the plaintiff was the result of conduct, on the part of
2 the defendant against whom punitive damages are sought,
3 manifesting a conscious disregard for the safety of the plain-
4 tiff or a person the defendant reasonably should have antici-
5 pated would have been endangered by his conduct.

6 “(b) Mere negligent conduct shall not be sufficient to
7 establish conscious disregard for the consequences of an act.
8 A failure to exercise reasonable care in choosing among al-
9 ternative product designs, formulations, instructions or warn-
10 ings, or a mere failure to warn of a product’s conditions or
11 propensities, shall not be sufficient to establish such conduct.

12 “(c)(1) Punitive damages awarded in any civil action to
13 which this chapter applies shall be paid to the clerk of the
14 court in which the action is pending.

15 “(2) Such awards of punitive damages shall be transmit-
16 ted promptly to the Treasurer of the United States, for the
17 use of the Administrative Office of the United States Courts
18 and the Federal Judicial Center.

19 “§ 2127. Counsel’s liability for excessive costs

20 “(a) In any civil action in which this chapter applies,
21 any attorney or other person admitted to conduct cases in
22 any court of the United States or any district court for the
23 Virgin Islands, Guam, the Canal Zone, or the Northern Mar-
24 iana Islands, whose conduct in the course of the proceeding is
25 calculated for delay, or is determined by the court, after con-

1 sideration of the circumstances, to have been in bad faith,
2 shall be subject to pecuniary sanctions by the court. Such
3 sanctions shall not be less than the total amount of court
4 costs, fees, and expenses, including attorney's fees reasonably
5 attributable to the conduct.

6 “(b) In any proceeding in which the court finds that the
7 action was initiated without a good faith belief by the attor-
8 ney initiating the cause of action that there was a reasonable
9 basis in law and in fact for recovery of the relief requested, or
10 that the action was initiated merely for purposes of achieving
11 a monetary settlement where there was no reasonable pros-
12 pect for an award of damages, then such attorney shall be
13 liable for treble costs, fees, and expenses, including attorney
14 fees reasonably incurred to respond to or otherwise resist the
15 action.”.

16 (b) The table of chapters for part V of title 28, United
17 States Code, is amended by adding at the end thereof the
18 following:

“135. Limitations and Procedures Regarding Civil Damages 2121”.

19

EFFECTIVE DATE

20 SEC. 4. This Act and the amendments made by this Act
21 shall be effective on the date of its enactment, and shall apply
22 to all civil actions filed on or after such date, including any
23 civil action in which the harm or the conduct complained of
24 occurred before such effective date.

